

ARMENIA 2013

**A YEAR OF EXPECTATIONS
AND SURPRISES**

ARMENIA 2013. A YEAR OF EXPECTATIONS AND SURPRISES.

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A YEAR OF EXPECTATIONS AND SURPRISES

This is the sixth year that the Civilitas Foundation publishes its annual report. We look back at the past year and attempt to assess and analyze Armenia's foreign policy, domestic developments and trends, as well as the economic situation in the country – all within the context of a changing global and regional environment.

With this report, as with previous ones, we have tried not only to identify the most important events of the year, but also to focus on trends and structural changes. The year was replete with expectations on all sides.

In a year with two elections – presidential and Yerevan municipal – hopes and expectations were high that this time, something would be different, and the elections would be perceived as legitimate, regardless of who came out on top. After all, in the absence of a strong opposition candidate, it was reasonable to expect that there would not be a need to utilize administrative resources to guarantee a re-election. This expectation was not met, but there was a surprise – the opposition candidate received more than one-third of the vote and that was sufficient for the public to want and expect a different outcome. It did not happen.

The international community, and Armenia's own citizens, expected that Armenia would continue on the path it had chosen nearly two decades ago – to more deeply integrate within European institutions. Yet, at the last minute, in what could only be described as a surprise to all, Armenia's president chose to take Armenia into the Russian-

led Customs Union. The eternal question, Russia or the West, seemed to have found its answer. If in the past, Armenia had been able to sustain normal and pragmatic relations with all three geopolitical centers — Moscow, Brussels and Washington — and balance their interests to Armenia's benefit, that was no longer to be expected. In the eyes of a surprised West, and an expectant Russia, Armenia was no longer a predictable and reliable partner.

In 2013, the poor and the unemployed expected some improvement in their lives. The president had promised seven percent growth. It was not a surprise that that goal was not achieved, nor was it a surprise that no one was held accountable.

Opinion polls show that, given the opportunity, hundreds of thousands of Armenians would leave Armenia. Official statistics confirm this. In the first nine months of 2013, more than 120,000 people left and have not returned. During the last six years, on the current government's watch, every tenth citizen has left the country, either temporarily or forever.

There is no indication that, in the coming year, expectations ought to be different. There is no policy in place to decrease the levels of poverty or unemployment, or to try to halt emigration or encourage in-migration. Neither Armenia-Turkey relations nor the Karabakh conflict expect to be resolved. Relations with Georgia are not expected to markedly change.

If there are surprises, they will be in the realm of domestic politics. More active civic engagement, the formation of a more resolute opposition, and a more varied set of demands of the authorities – these are the surprises many hope for.

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2013 was the year when the foreign policy focus of each of the three South Caucasus states shifted so significantly that by year's end, Armenia, Azerbaijan and Georgia were left with even less in common than they had before.

Yerevan, Baku and Tbilisi were preoccupied with redefining relations with Russia and the European Union. The process was convoluted, with several unexpected turns and the outcomes differed greatly. Thus the two international crises much less than a few hundred kilometers away — the civil war in Syria and Iran's nuclear program — receded into the background. And perhaps because of those crises, international attention was not on the Caucasus.

In 2013, the world's attention was focused on the continuing conflict and violence in the countries which had embraced the Arab Spring. In addition to Egypt, and to some extent Iraq, Libya, Yemen, Lebanon and Tunisia, for whom 2013 was an unstable year, Afghanistan and Pakistan maintained their own familiar instability, and even Turkey underwent serious internal shock.

But the focus was on Syria where the world watched in dread as more than a hundred thousand were killed, and millions deported or sought refuge.

Syria's nearly 50,000-strong Armenian community as well as those around the world who trace their roots to Syria, were directly affected as, nearly 100 years after the first World War, the imposed patchwork peace began to break down.

Armenia, and to some extent Karabakh as well, continued to receive immigrants from Syria, estimated to number around 10,000. The Syrian

Armenian community count has dwindled to some 20,000 remaining in Damascus and Aleppo where war wages ceaselessly, as well as in the comparatively peaceful Kurdish-controlled city of Kamishli and the Alewi-controlled seacoast.

The end of the year also saw tensions rise in Ukraine, when hundreds of thousands of people took to the streets in Kiev and in western Ukrainian cities, demanding that the government follow through with their initial intention to sign the Association Agreement with the European Union. This, after the Ukrainian president did an about-face, under pressure from Moscow, and refused to sign just days before the European Union Summit in Vilnius on November 28–29. Calls for the president's and the government's resignation soon followed.

GEORGIA

Moscow had made clear in late 2012 its hopes that the defeat of President Mikheil Saakashvili's United National Movement (UNM) in the October parliamentary election would pave the way for more constructive, less strained and hostile relations.

The new Georgian government headed by billionaire Bidzina Ivanishvili adopted a pragmatic approach with regard to economic cooperation while maintaining the UNM's unyielding position with regard to the breakaway Georgian regions of Abkhazia and South Ossetia.

Veteran Georgian diplomat and former Ambassador to Moscow Zurab Abashidze and Russian Deputy Foreign Minister Grigori Karasin held four rounds of talks that, in Karasin's words, put an end to "the epoch of maniacal enmity instilled by the previous leadership." In Moscow, President Vladimir Putin received the Georgian Patriarch Ilia II, and in Davos, Russian Prime Minister Dimitrii Medvedev met with Georgian Prime Minister Ivanishvili.

Moscow lifted the ban imposed in 2006 on the import of Georgian wine, mineral water and agricultural goods. As a result, Georgia's trade turnover with Russia grew by 38 percent. The

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number of Russian visas granted to Georgian citizens increased by 40 percent.

Still, like the previous Georgian leadership, Ivanishvili's government, too, steadfastly rejected the idea of signing formal agreements on the non-use of force with Abkhazia and South Ossetia. At the same time, Tbilisi continued to rule out the formal restoration of diplomatic ties with Russia (which were severed in the wake of the August 2008 war) unless Russia revokes its recognition of Abkhazia and South Ossetia as independent sovereign states.

Armenia, and to some extent Karabakh as well, continued to receive immigrants from Syria, estimated to number around 10,000

Consequently, no Russian officials were invited to the inauguration on November 17 of Mikheil Saakashvili's successor as president, Giorgi Margvelashvili.

Those elections were competitive and highly rancorous. The Georgian Dream became reality. Margvelashvili won in the first round, with more than 60 percent of the vote. All observing organizations — European and Russian — assessed the elections to be free and fair.

The elections were preceded by months of bitter charges in both directions. The Saakashvili camp, and Saakashvili himself, frequently accused the new leadership of not being sufficiently Western-leaning, and sabotaging the spirit of the revolution. In turn, Saakashvili and many members of his team were charged — both rhetorically and legally — with corruption, improper use of administrative resources, prisoner abuse and other infringements of power. So intent was the Ivanishvili government in its pursuit of the former officials that European leaders cautioned the new government that they might be sacrificing their future by so zealously retaliating against the past.

Still, the new Georgian administration, like the previous one, remained focused on European integration. They succeeded in concluding the European Union Association Agreement negotiations and actually initialing the agreement with the leadership of the EU in Vilnius, at the EU Eastern Partnership Summit in November. Thus Georgia became the only country in the Caucasus to embark on this next step in European integration.

Georgia either was not subjected to the same intensity of pressure that Russia brought to bear on Ukraine or Armenia, or the Georgian authorities had become accustomed to ignoring the Russian factor in their calculations.

In the midst of domestic tensions, an uncertain transition, and regional pressures, Georgia's economy stalled. In 2013, GDP growth was a bare two percent.

Helping Georgia manage the problem of heightened expectations and reduced growth is its extremely low military budget, which stood at \$360 million in 2013. Georgia had engaged in a large-scale military build-up prior to the 2008 war, when its annual military spending reached \$1 billion, with the country purchasing offensive weapons such as aircraft, tanks and artillery. The build-up proved insufficient against Russian military. Georgia recognized that the lack of Western military support and Russia's establishing permanent military bases in Abkhazia and South Ossetia, made any future offensive military action by Georgia effectively meaningless.

Following the war, Georgia began to decrease spending and re-focus on less expensive acquisitions, such as air defense and anti-armor weapons. And in a move so far unprecedented in the Caucasus, the new Georgian leadership announced plans to sell off much of the country's armor and aircraft holdings to reduce maintenance costs and raise funds for defensive military needs. Georgia also scaled back ambitious Saakashvili-era defense industry programs and reportedly sought to sell its Soviet-era aircraft manufacturing plant to Azerbaijan.

Meanwhile, Georgia's multi-faceted bilateral cooperation with Turkey, and trilateral

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cooperation between Georgia, Azerbaijan and Turkey grew. Visiting Tbilisi in February, Turkish Prime Minister Recep Tayyip Erdogan said Georgian-Turkish relations should serve as an example for the other countries of the region.

In the first 10 months of 2013, Turkey was Georgia's biggest trading partner, with \$1.2 billion in total trade, about 14.2 percent of Georgia's total trade. Turkey held the same status in 2012, when trade volume was slightly higher, at \$1.3 billion in the same period in 2012,

The foreign ministers of Georgia, Azerbaijan and Turkey met in Batumi in March to build on the trilateral cooperation declaration signed the previous year. Georgian Foreign Minister Maia Panjikidze singled out the two countries as among Georgia's most important regional economic partners.

The cordial relations Georgia enjoyed with Iran in recent years cooled in July after Tbilisi unilaterally revoked the 2010 agreement allowing Iranians to visit Georgia without a visa. The Georgian authorities also froze the Georgian bank accounts of some 150 Iranian persons or commercial entities to whom UN sanctions apply after rumors that Iran was circumventing sanctions with Georgia's assistance.

AZERBAIJAN

Prior to Azerbaijan's presidential election in October, Armenian President Serzh Sargsyan had said that Azerbaijani President Ilham Aliyev's reelection would probably be most convenient for Armenia.

And that's what happened. Ilham Aliyev won for the third time after inheriting the presidency from his father in 2003. He received 85 percent of the vote, to opposition candidate Camil Hasanli's six percent.

This was the first time that the two opposition parties had fielded a joint candidate. Hasanli, a historian, became the flag bearer when the Russians refused to release Rustam Ibragimbekov of Russian citizenship and the Azerbaijani

authorities barred the celebrated film maker on the grounds that he has dual citizenship.

The European Union and the OSCE – ODIHR as well as western countries, including the US, stated that the elections were not in line with international standards.

Tbilisi continued to rule out the formal restoration of diplomatic ties with Russia unless Russia revokes its recognition of Abkhazia and South Ossetia as independent sovereign states

Aliyev's new government did not include Safar Abiyev who had been defense minister for the last 18 years, and who was perceived as among the most corrupt. Artur Rasizade, 78 years old, remained prime minister, a post he has held since 1996.

Following Azerbaijan's refusal in December 2012 to renew Russia's lease of the Gabala radar station, the country's leadership continued to combine pragmatism and assertiveness in their approach to Russian-Azerbaijani bilateral relations. The pragmatism was evident during Russian President Vladimir Putin's August visit to Baku, during which two important agreements were signed between the state-owned Russian oil company Rosneft and Azerbaijan's SOCAR. Azerbaijan has also placed orders for Russian weaponry to the value of \$1 billion. The first foreign visit by Zakir Gasanov, who replaced veteran Defense Minister Abiyev in October, was to Moscow.

The assertiveness was demonstrated on the eve of that same visit, by the detention of members of the Moscow-sponsored Federal Lezgin National Autonomy, a body the Azerbaijani leadership perceives as an instrument Russia could use against Azerbaijan's own Lezgin minority.

Despite religious and cultural commonalities, there are serious contradictions in Iran-Azerbaijan

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relations, some of which are historic, others political. Azerbaijan is a Turkic country, but unlike Turkey where the majority population is Sunni, 60 percent of Azerbaijan's population is Shia Muslim. Iran, of course, is the cradle of the Shia arm of Islam. Thus, Baku continuously accuses Iran in trying to extend its influence over Azerbaijan, through religion.

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Disagreement over the status of the Caspian Sea is another area of tension between the two countries, which hold opposing positions. Another area of discord is Azerbaijan's territorial aspirations over certain regions of Northern Iran, which is populated by millions of ethnic Azeris.

Baku remains convinced that despite public statements and votes cast in international fora, Tehran is backing Armenians in the Karabakh issue. Tehran, in turn, has clearly said that Azerbaijan is supporting Israel. Besides buying armaments from them, Azerbaijan is perceived as the West's and Israel's best friend in the region, primed to strike against Iran, if necessary.

There were no high level visits between the two. Ilham Aliyev's Chief of Staff Ramiz Mehtiyev, considered to wield a great deal of power in the Azerbaijani system, visited President Mahmud Ahmadinejad in March. There were practically no reports about the outcome of the meeting.

For Azerbaijan, the year's major accomplishment was the signing, on December 16, of the

agreement to enter into Phase 2 of the Shah Deniz gas field development and exploitation. This will signal the start of some \$25 billion investment on the gas field itself, and another \$20 for the pipelines which will carry the gas through Turkey to Europe, beginning in 2019. A total of \$46 billion in global investments will begin to see a return no earlier than 2029. Sixteen billion cubic meters of gas will travel from Azerbaijan through Georgia to Turkey, which will keep six billion and transport the rest to Europe. Europe's annual gas demand in 2019 is expected to reach 490 billion cubic meters. Thus Azerbaijan will fulfill some two percent of Europe's needs.

In parallel, Azerbaijan considerably expanded its lobbying in both the US and Europe. The Azerbaijan America Alliance (AAA) led by the son of Azerbaijan's transport minister – one of the richest people in the country – held two massive events. In May, a huge American contingent that included former advisors to President Obama, eleven sitting members of Congress and dozens of state-level officials from more than 40 US states, descended on Baku. AAA held a follow-up party in Washington in October with four US senators and 13 congressmen co-hosting the “celebration of relations.”

Azerbaijan's European efforts are led by the sons of its minister of emergencies, reputed to be even richer than the transport minister. A mid-year report by a European think tank referred to ‘caviar diplomacy’ to explain the sources of Azerbaijan's support in European institutions.

TURKEY

In the absence of any tangible successes in relations with neighbors, Turkey's Justice and Development Party (AKP) embarked on a reconciliation process with Turkey's own Kurdish population and the Kurdish Workers' Party, and also ventured into direct relations with Iraqi Kurdistan, thus complicating further its relations with Baghdad's ruling Shiites.

In November, in the southeastern Turkish city of Diyarbakir, which the Kurds consider the capital of Kurdistan, Turkish Prime Minister Recep Tayyip Erdogan hosted Masud Barzani, and

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welcomed him as the leader of the Iraqi Kurdistan Region, thus using the term ‘Kurdistan’ publicly. This was the first of a string of public uses of the term. Diyarbakir Mayor Osman Baydemir even spoke of Turkish Kurdistan on television. He said Erdogan’s statement was not revolutionary, rather it removed the shame of the past.

The initiative to resolve tensions with Turkey’s Kurds had started early in the year, when Erdogan initiated negotiations with the incarcerated Kurdish leader Abdullah Ocalan. As a result, during the year, there was not a single casualty as part of Kurdish–Turkish confrontations.

The Turkish authorities reached out to the Syrian branch of the Kurdish Workers’ Party as well, thus establishing a dialog not just with the Kurds of Turkey, but also with those of Iraq and Syria, going counter to the central governments in Baghdad and Damascus.

Turkish–Israeli relations thawed when Israeli Prime Minister Benjamin Netanyahu apologized in March for the loss of life in the Mavi Marmara incident in 2010. On the other hand, relations with Egypt became heated when the army removed President Mohamed Morsi in July and fired on the Moslem Brotherhood. Erdogan called it a massacre. Relations with Lebanon also soured when two Turkish pilots were kidnapped in Beirut as a result of the Syrian conflict.

And there were new domestic challenges. In June, major demonstrations in dozens of Turkish cities shocked Prime Minister Erdogan and his administration. They did not know how to deal with calls for democratization that arose from government’s unvetted construction plans in Istanbul’s Gezi Park. The international community’s conclusion was that the authorities were not prepared to listen to the demonstrators and used disproportionate force.

By year’s end, the Erdogan administration found itself under even greater pressure. Police and prosecutors focused on ministers and others in government, charging them with corruption. Erdogan called this a conspiracy against himself and his party, and proceeded to relieve hundreds of officials in the law–enforcement sector of their

positions. Erdogan insisted that the prosecution was instigated by foreign governments. But his primary focus were the followers of Fethullah Gulen, part of an international religious and social movement with millions of followers within and outside Turkey. This was not the first time during the year that Erdogan challenged the Movement’s foothold in society, but was certainly one with huge ramifications for the next several months and for the Turkish local elections scheduled for March 2014.

Following Azerbaijan’s refusal in December 2012 to renew Russia’s lease of the Gabala radar station, the country’s leadership continued to combine pragmatism and assertiveness in their approach to Russian–Azerbaijani bilateral relations

The demonstrations and the government’s response adversely affected Turkey–European Union relations as well. Several planned visits were cancelled. The opening of a new chapter in Turkey–EU accession negotiations were postponed. The European Commission’s Progress Report on the accession process was released in October. It was critical of the Gezi Park events, unfulfilled promises and reforms, but welcomed the democratization package which the government had made public. The package — one of the most important initiatives of Erdogan’s government — consists of proposals some of which are unprecedented. Many linguistic, educational, social obstacles and taboos are lifted for Kurds and Kurdish communities. The proposed changes affect the Turkish population as well.

In the context of such deep and significant overtures to the Kurdish community, Ankara’s continued resistance to all things Armenian remains problematic.

The resolution five years later of the Ergenekon cases, where several hundred high level officials

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were questioned, and more than 100 convicted, in no way helped ease the tension that continues over the legal process aimed at resolving the Hrant Dink assassination of 2007. Although Dink's attorneys insist that there is a direct link with the Ergenekon plotters and those still in office, the government has twice shut down such inquiry.

For the Armenians of Istanbul, it was another year of contradictions. Being Armenian in Turkey remains challenging. On the one hand, the government returned to community institutions certain property and assets which had been seized half a century ago. On the other hand, in the Samatya district of Istanbul — a highly Armenian populated neighborhood which has for centuries been home to the Patriarchate of the Armenian Church — Armenians became the target of violent attacks. Two were killed. The authorities arrested an Armenian who said in court that he was not responsible. Istanbul's Christian churches, too, were attacked, the Armenian Patriarchate's mother church among them. While Turkey's Human Rights Association insisted that the crimes were racially motivated, Turkish officials rejected that possibility.

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April 24, the day marking the beginning of the 1915 Genocide against Armenians perpetrated by the Ottoman rulers, was commemorated in Istanbul and several other cities as well. This is not the first year that various Turkish individuals and organizations have undertaken such demonstrative memorials. In Istanbul, the participants numbered more than 1,000 people, including a number of Armenians from the Diaspora.

In June, in Istanbul's Beyazit Square, a small group of Turkish advocates and members of the Social Democrat Hunchakian Party (from Armenia and Diaspora) commemorated the hanging in 1915 of 20 prominent figures of the Hunchakian Party.

This year, the fourth year in a row, a church service was held in the Holy Cross Church on Akhtamar Island in Van, although attendance was lower than in years past. For the first time since 1915, the sacrament of baptism was also performed. Six people from Armenia and Turkey were baptized during the September service.

For the first time, there was a protest on the occasion of the ceremony on Akhtamar, and the organizers were not Turks but Azerbaijanis. Four Turkish-Azerbaijani organizations, including members of a Dutch-Azerbaijani Cultural Organization organized a demonstration not on the island, but on the road directly across the island, commemorating the "50 Moslem women and people of Van who were killed by Armenian terror groups."

Just two days later, another church service was held, this time in Diyarbakir, in what is considered to be the largest Armenian church in the Middle East — the St. Giragos Armenian Apostolic Church. This was the first service in 98 years and was attended by hundreds from within Turkey and abroad. Kurds, too, attended, most notably the mayor of Diyarbakir. He had been instrumental in helping raise government funds for part of the \$3 million renovation (also supported by Armenians from Istanbul and the Diaspora.) Per a 2011 law, the Turkish government is returning to religious minorities the assets and properties seized from them in 1936. and as part of this. the Diyarbakir Armenian church has received 17 of the more than 190 properties seized.

September also saw the erection, also in Diyarbakir, of a Memorial to a Common Conscience for the pain experienced by Turks, Kurds, Arabs, Armenians and Assyrians before and after the creation of the Republic of Turkey.

NAGORNO KARABAKH

In 2013, those engaged in the Nagorno Karabakh conflict focused not so much on seeking solutions

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for a lasting peace as they were in acquiring armaments. Ceasefire infractions have become common not only in the Karabakh conflict area, but all along the Armenia–Azerbaijan border.

In the northeastern Noyemberyan–Kazakh region, the interstate Yerevan–Tbilisi highway which lies outside Armenia’s boundaries but has been under the control of Armenian forces, was closed several times in July, because Azerbaijani sniper fire had made the road unsafe. In November and December, the road remained shut and instead traffic was diverted to a secondary road farther west. The same set of events took place in October on the Berd–Ijevan road, where one person was killed and several soldiers and civilians were wounded. Oddly, similar ceasefire violations have taken place along Armenia’s southwestern border with Azerbaijan’s Nakhichevan exclave, where everything had been peaceful even during the military conflict itself as well as after the 1994 ceasefire.

In 2014, Azerbaijan will spend \$3.8 billion on armaments — an amount significantly higher than the combined budgets of the Republic of Armenia and that of Nagorno Karabakh. In June, on Azerbaijan’s Army Day, President Aliyev pointed out that in 2003 Azerbaijan’s military budget was \$163 million. Thus in 10 years, military appropriations have grown by 23 times.

Azerbaijan bought \$1 billion in military equipment from Russia, including the offensive SMERCH multiple-rocket launchers. During Putin’s visit to Baku, it was announced that Azerbaijan has bought \$4 billion in armaments from Russia since 2010.

In response to Armenia’s concerns, Russia insisted that Russian arms sales to Azerbaijan do not disrupt the military balance.

Visiting Karabakh in late August, Armenia’s Prime Minister Tigran Sargsyan likewise claimed a dramatic rise in Armenian arms acquisitions. “In the last three years we have acquired as much weaponry as we did in the previous 20 years,” he said. At year’s end, when he visited military posts on the frontline, he announced that the Armenian army would soon have armaments the likes of which they haven’t seen in the past.

Russia has made “maintaining the balance” a rhetorical centerpiece of its policy on Karabakh. “Balance” in the Russian government’s understanding is selling its most modern – and most expensive – military equipment to Azerbaijan, transferring second-hand but fairly decent materials to Armenia for almost free and substantially reinforcing the Russian military base in Armenia, thus deterring Azerbaijan from using its newly acquired arsenal.

In the absence of any tangible successes in relations with neighbors, Turkey’s Justice and Development Party (AKP) embarked on a reconciliation process with Turkey’s own Kurdish population and the Kurdish Workers’ Party

Until recently the base had a decidedly defensive posture focused on the upgrades of its air defense component that since the early 2000s included the long-range S-300 surface-to-air missile systems and a squadron of MiG-29 air superiority fighters. Earlier this year, Russian officials also let it be known that the base now includes medium-range Iskander surface-to-surface missiles. With a range of up to 400 kilometers, Armenia-based Iskanders (not yet shown publicly) can strike any target between Yerevan and Baku with deadly accuracy and thus present an ultimate deterrence weapon in the Armenian–Azerbaijani standoff. The Russian base now also has a highly destructive, long-range (90 km) Smerch multiple-launch rocket system and a Mi-24 attack helicopter squadron.

Significantly, in an October 2013 interview with the official newspaper of the Russian Ministry of Defense, the base commander Colonel Andrey Ruzinsky made clear that his base could be engaged in case of Azerbaijan’s aggression against Nagorno Karabakh, even though it falls formally outside Russia’s treaty obligations to Armenia. In

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effect, as was the case with the withdrawal from Georgian bases a year before the 2008 war, the withdrawal of Russian military personnel from the radar base in Azerbaijan in late 2012 makes a hypothetical threat of Russian military action against Azerbaijan more credible.

The demonstrations and the government's response adversely affected Turkey-European Union relations as well. Several planned visits were cancelled. The opening of a new chapter in Turkey-EU accession negotiations were postponed

At the same time, beginning in 2011, Russia has lifted most restrictions on weapons sales to Azerbaijan, supplying the country with modernized S-300 SAMs, two dozen Mi-35 (upgraded Mi-24) combat helicopters and most recently nearly 100 T-90 tanks, and modern artillery and short-range air defense systems. Total Azerbaijani contracting from Russia has exceeded \$4 billion, making Russia the main weapons supplier to Azerbaijan and Azerbaijan one of the major buyers of Russian equipment. The only restrictions that Russia still appears to maintain with regard to Azerbaijan are on sales of combat aircraft, naval and missile systems. Awash in cash, Azerbaijan has made additional purchases from Israel, Turkey and South Korea, also estimated in the billions of dollars, including dozens of unmanned aerial vehicles (UAVs), artillery and air defense systems, and even submarines.

Outmatched in cash, Armenia is increasingly left reliant on Russia for pre-empting an Azerbaijani attack. Russian military transfers or deeply subsidized sales to Armenia in recent years have included S-300s, other missile systems, Mi-24s and ground equipment, and can be estimated to be in excess of \$1 billion. At the same time, not all has been smooth in military cooperation with Russia. Armenia has turned to countries like

China, Ukraine, Poland and Slovakia to fill in the gaps for its military needs, including, according to some sources, the Chinese AR1A equivalent of the Smerch missiles.

While Azerbaijan still has no ready capacity to defeat Armenian forces on the ground, it has certainly amassed substantial resources to cause significant Armenian casualties if it were to initiate hostilities in the form of a massive artillery strike. Azerbaijan's air force capabilities are too limited to penetrate extensive Armenian air defenses. Armenia's counter-strike capabilities – particularly in the form of Armenia's own arsenal of Scud and Tochka ballistic missiles and long-range multiple launch rocket systems – and especially the notion that Russian forces might get involved is what makes any major escalation in Karabakh so unappealing to Azerbaijan.

As a result, in this no-peace no-war situation, the Azerbaijani leadership is likely to continue to resort to lower-intensity and lower-risk activities, such as what has become regular sniper fire and less frequent aerial maneuvers and special operations, to keep military pressure on Armenia and Nagorno Karabakh. For now, Armenian forces have contended with such pressure along the Line of Contact fairly well. Still, soldiers continue to die as a result of enemy fire. Baku refuses to pull back the snipers "so long as the war has not ended," according to the Azerbaijani Defense Ministry.

The Armenian and Azerbaijani presidents had one meeting in 2013 — in November, in Vienna. This was their first meeting since the January 2012 Sochi tete-a-tete. The post-meeting announcement in Vienna promised nothing more than more meetings. The absence of the word 'Madrid' was noticeable, which may be indication of the continuing effort to sideline the Madrid document of 2007 and its provision for a referendum by the people of Karabakh. The other change worthy of notice is that Azerbaijan's militaristic rhetoric seemed to have toned down.

The foreign ministers of Armenia and Azerbaijan met several times, in what seemed to be meetings for the sake of meeting — in January in Paris, in May in Krakow, in July in Vienna, in September in New York and in December in Kiev.

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In addition, the co-chairs of the OSCE Minsk Group also met with each minister separately once during the year. Together, they made five visits to the region — in March, April, May, November and December. In September, the newly-appointed American co-chair, Ambassador James Warlick, visited Baku, Yerevan and Stepanakert. In Baku and Yerevan, he transmitted US President Barack Obama's letter calling on the sides to bring new effort to bear in the search for peace. Ambassador Warlick is the first US co-chair whose portfolio is solely the Karabakh conflict.

During each regional visit, the co-chairs also met with the authorities of Nagorno Karabakh, in Stepanakert. The Stepanakert airport is a regular agenda item at these meetings. The newly-built airport has been standing idle for two years, because of Azerbaijan's threats to destroy any airplane attempting to use it, per a law passed in January on "The Use of Azerbaijan's Air Space." During this visit, the US and French co-chairs held a rare meeting with Karabakh's civil society and non-governmental representatives, at the Stepanakert Press Club.

In June, at the G8 Summit in Ireland, the presidents of the three Minsk Group co-Chair countries — Obama, Putin and François Hollande of France — issued a statement expressing "deep regret that, rather than trying to find a solution based upon mutual interests, the parties have continued to seek one-sided advantage in the negotiation process." This was the sixth such joint statement made by the heads of state during the life of the conflict.

In October, the European Parliament passed a resolution calling for a solution to the conflict that would correspond with the four UN Security Council resolutions of 1993 and the joint statement of the presidents of the co-Chair countries made at the 2009 G8 l'Aquila Summit.

In December, at the OSCE Ministerial Meeting in Kiev, a joint statement by the heads of delegations of the OSCE Minsk Group co-Chair countries as well as the foreign ministers of Armenia and Azerbaijan called on the sides to consider measures to decrease tension in the region.

Turkey continued to adopt a one-sided approach and support Azerbaijan's position in the negotiations process. During the Third Turkic Council Summit Meeting held in Gabala, Azerbaijan, in August, Turkish President Abdullah Gul went so far as to say that he hoped that one day that meeting would take place in Nagorno Karabakh.

For the Armenians of Istanbul, it was another year of contradictions. Being Armenian in Turkey remains challenging. On the one hand, the government returned to community institutions certain property and assets which had been seized half a century ago

Armenians and Azerbaijanis, themselves, instead of looking for fair and balanced solutions that would meet the minimal needs of the three sides, are instead focusing on ways to propagandize recent history. International forums and meetings are used primarily for that purpose. Azerbaijan is spending millions to mark the events in Khojalu, accusing Armenian military forces of deliberately killing civilians, at the height of the military conflict. Azerbaijan attempts to turn those commemorations into anti-Armenian actions, and present them in various state or local legislatures as premeditated destruction by the Armenian side. As a result, some countries and states did in fact recognize those 1992 events as evidence of one-sided Armenian atrocities.

At the French National Assembly, Azerbaijanis refused to honor a moment of silence in memory of the Armenian victims of the Sumgait pogroms carried out in February 1988 in response to the start of the democratic movement. The Azerbaijanis were removed from the building after fisticuffs ensued with Armenians. The French Foreign Ministry rebuked the participants.

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Karabakh's representatives have undertaken diplomatic steps to achieve Karabakh's recognition and to establish friendship groups with various parliaments. In France, a friendship group was established with the participation of members of the National Assembly as well as political and intellectual figures. In Lithuania, the Seim formed a friendship group. Azerbaijan sent formal diplomatic notes to Lithuania and France, in protest.

In June, in Istanbul's Beyazit Square, a small group of Turkish advocates and members of the Social Democrat Hunchakian Party (from Armenia and Diaspora) commemorated the hanging in 1915 of 20 prominent figures of the Hunchakian Party

In the US, the states of Maine and Louisiana, and the California cities of Fresno and Highland, all passed resolutions recognizing Karabakh's independence or its right to develop its free and independent status.

Armenia's National Assembly again took up the issue of Armenia's recognition of Karabakh's independence. This is the third time this discussion has taken place, and the third time that it did not pass. The parliamentarians who voted in favor — 11 in all — were mostly from the Armenian Revolutionary Federation — Dashnaktsutyun and from the Heritage party, which had authored the bill. The rest did not participate in the vote.

Just as the frequency of official contacts has diminished, so have contacts between NGOs and other civil society actors. Indeed, a document presented (but not passed) in the Azerbaijani parliament threatened to make illegal any cooperation with the Armenian side, without Baku's official permission. Even in the case of prisoners exchange, Azerbaijan makes the interactions difficult.

As part of its effort to minimize international interaction with the Armenian side, Azerbaijan has both expanded and publicized its 'black list' of officials, journalists, artists and others who visit Karabakh. The 335-name list that the Azerbaijani MFA proudly displayed soon became the object of derision, however, by international figures who had visited and whose names were missing, or by others who announced they would soon visit Karabakh, simply for the 'honor' of being included.

Baku's use of public relations firms and techniques is indiscriminatory and international. From artistic venues to commercials on international television outlets, it promotes the positive, while at the same time blaming and punishing those officials whose countries 'allow' the publication of less-than-positive articles in their press. Several years ago, US diplomats in Baku were punished when the Washington Post published a piece about the wealth of the youngest of Aliyev's children. This year, Russian diplomats were punished for Novosti's piece by Vadim Dubnov entitled, "In 25 years, Karabakh has learned not to be recognized." Unlike the Washington Post, Novosti removed the article from its site.

Azerbaijan demonstrates no interest in cooperation of any kind with the Armenian side. When the authorities in Stepanakert announced that they are ready to discuss with Baku issues related to the joint use of the Sarsang Reservoir and the Tartar River in Karabakh's north, and to making water available to Azerbaijan, there was no response.

Not only is there no indication of readiness to cooperate, but Azerbaijan has adopted new methods of vilifying Armenians. Azerbaijani writer Akram Ailisli fell victim to Baku's official ire upon the publication of his novel *Stone Dreams*. It's a story of Agulis, the Armenian region where the author was born, and whose Armenian population was decimated 90 years earlier. The heroes of *Stone Dreams* are Azerbaijanis living in Baku in the 1980s, at the time that the massacres of Armenians were taking place in Sumgait and Baku. The novel was published in a Russian literary journal, *Druzba Narodov*.

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President Aliyev retracted Ailisli's national award as a man of letters. Ailisli was rebuked strongly in the Azerbaijani Parliament. He was accused of denigrating the integrity of the Azerbaijani people. Organized protests and book burnings were accompanied by calls of treason and members of his family were removed from their positions. Even Azerbaijan's religious leader joined the melee and called him godless and a heretic.

Despite the officially-sanctioned attacks on his person and his work, Ailisli repeatedly insisted that the events described in *Stone Dreams* correspond absolutely to truth and real events. He said the book was written not for Armenians, but for Azeris. Nevertheless, three Armenian publishers published the book in Armenia within months of the Russian publication.

Armenian publications are not allowed into Azerbaijan; they are labeled "extremist literature." No other kinds of Armenian products are allowed in either. This is in stark contrast to the situation less than 10 years ago when Armenian cognac and cigarettes could be found on Baku's store shelves.

For internal Karabakh politics, it was a good year. Freedom House placed Karabakh in the 'Partly Free' category, as opposed to the previous few years' 'Not Free.' As a consequence, or as further evidence of the improvement, in the village of Khachen, in late February, a new political party was formed, vocal in its opposition to the ruling party.

To strengthen Karabakh's economic potential and accessibility, as well as motivated by security concerns, a 116 kilometer (50 mile) road will be constructed in the coming years between Vardenis, in Armenia's east, near Lake Sevan, to Martakert in Karabakh's north. The focus of the government's Armenia Fund 2013 telethon was the construction of this road.

ARMENIA — TURKEY

Expectations of and responses to Turkish Foreign Minister Ahmet Davutoglu's one-day visit to Yerevan in early December exemplified Armenia-Turkey relations today.

The Foreign Minister arrived in Armenia to participate in the Black Sea Economic Cooperation's semi-annual Ministerial Meeting. Four years earlier, in the heyday of the development of the Protocols process that was intended to lead to diplomatic relations and an open border, Davutoglu's predecessor Ali Babacan came to Armenia, in April of 2009. Babacan met with President Sargsyan. Davutoglu did not. Instead, he held a longish tense meeting with Armenian Foreign Minister Edward Nalbandian, at the conclusion of which they issued a one-line statement.

Azerbaijan bought \$1 billion in military equipment from Russia, including the offensive SMERCH multiple-rocket launchers. During Putin's visit to Baku, it was announced that Azerbaijan has bought \$4 billion in armaments from Russia since 2010

According to the Armenian Foreign Ministry's statement, Nalbandian reiterated Armenia's insistence that Armenia-Turkey relations be discussed without preconditions, referring to Davutoglu's linkage of Armenia-Turkey progress to the Karabakh resolution process.

Both seemed focused on 2015, and the 100th anniversary of the beginning of the Armenian Genocide. Armenia intends to maximize its advantageous position in anticipation of international attention, and is still intent on seeing the protocols concluded. Ankara wants to demonstrate to the international community that there is a bilateral process on the ground, and therefore third countries should not intervene or invoke 1915 and its consequences.

Ankara, unlike Yerevan, does not discourage civil society or other kinds of joint activities. Yerevan, on the other hand, actively discourages those organizations on which it has influence.

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Still, Ankara's efforts are conditioned by Baku's reactions. In April, after long negotiations, an Armenian-Turkish venture was to initiate weekly flights between the eastern Turkish (and historically Armenian) city of Van and Yerevan. The clear symbolism and the proximity of the two cities was the driving motivation. The beneficiary would clearly have been the Turkish side, with Armenian citizens and tourists making the journey to the lake and the entire region. At the last moment, the Turkish side succumbed to pressure from Baku and the flights were indefinitely delayed.

While Azerbaijan still has no ready capacity to defeat Armenian forces on the ground, it has certainly amassed substantial resources to cause significant Armenian casualties if it were to initiate hostilities in the form of a massive artillery strike

In November, the Armenian Revolutionary Federation – Dashnaktsutyun Bureau, the organization's highest body, sent a delegation to Istanbul to participate in the Socialist International Council Meeting. The ARF had not officially participated in anything in Turkey since 1923. The Dashnaktsutyun members met with members of the pro-Kurdish Peace and Democracy Party. Similar meetings between the two parties had been held in Washington DC a month earlier. The statement issued by the Dashnaktsutyun after the meeting said that the sides discussed "the likelihood of Armenian-Kurdish cooperation, based on Western Armenia and Kurdistan, and the national and democratic dreams of the Armenian and Kurdish peoples."

There are other efforts to bridge the gap of understanding between Armenians and Turks. In December, an Armenian and a Turkish actor set the world record for the longest lasting handshake. The purpose they said was to

demonstrate that despite the existing problems, contact is possible between the two peoples.

In November, the Civilitas Foundation became the first Armenian organization to establish a presence in Turkey. Civilitas intends to work with Turkish and Armenian individuals and organizations to contribute to efforts to open the border, to highlight the Armenian community of Istanbul, and to offer forums for activities that will help fill the information gap about Armenians in Armenia, in the Diaspora, and in Turkey, before and after the Genocide.

Armenia-Turkey trade remains an interesting indicator of relations. Ankara places a 1000 percent customs fee on Armenian imports. Trade from January to October, 2013, was \$165 million, which is a bit less than the same period in 2012, and comprises 3.5 percent of Armenia's overall trade. Because of the closed border between the two countries, trade is conducted through Georgia.

ARMENIA – IRAN

Both Iran and Armenia held presidential elections in 2013. The vote that elected Hasan Rouhani president was not questioned either within Iran or abroad.

But two decades of Armenia-Iran relations have demonstrated that regardless of who holds the presidency in either country, or the nature of the governments' economic or foreign policies, Armenia-Iran relations are not affected. The reason is that both Yerevan and Tehran are aware of each other's minimal requirements and the imperative need that they be met.

Iran's then-foreign minister attended Serzh Sargsyan's inauguration ceremony. But Sargsyan himself was present at Rouhani's oath-taking when they held their first meeting, although they had met earlier in 2001 in Yerevan, and in 2005 in Tehran, when both held other positions.

It is important for Armenia to be able to count on firm relations with Iran. This is important to offset Turkey's influence in the region. It is also important because Iran, like Georgia,

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offers Armenia an outlet to the world, given the closed borders to the east and west. Iran can also become an alternative energy source, at least in theory, depending on what limitations result from Armenia–Russia negotiations, and the consequences of Iran’s negotiations on nuclear power, with the West.

At the end of the year, after Armenia’s gas deal with Russia became public, the Iranian ambassador in Yerevan announced that Iran can provide Armenia with cheaper gas. Armenian officials responded saying it’s possible to negotiate such a deal if the Iranian gas price does not exceed \$189. The physical transport of the gas would be easy since the gas pipeline, constructed in 2007, serves to send gas to Armenia, which currently is completely transformed to electricity and sent back to Iran.

Regular mid and high level visits took place throughout 2013. In addition to the Iranian foreign minister’s visit in April, for President Sargsyan’s inauguration, Iran’s chief prosecutor also visited Armenia and signed an agreement on cooperation against transnational crime.

Political relations remain warm while progress on economic projects is sluggish.

Energy ministers visited each other’s countries and were received by the presidents. Cooperation in the energy sector remains a priority and the sides stressed again the importance of the third 400w high voltage electricity transmission line which was to have been built in 2010. They also repeated the significance of the two 130mw hydro electric stations one on each side of the Armenian–Iranian border. The symbolic start of construction on these took place in 2012, with the participation of Armenia’s president. But neither of the two projects has moved. The first project is to cost \$146 million, and the second \$323 million, with the Iranian side financing both.

In the agriculture sector, a slaughterhouse was set up in Armenia’s southern Syunik region in the summer of 2013, specifically to prepare and sell sheepskin and mutton. Iran is foreseen as an important market for mutton and lamb, and experts from Iran are employed to assure that

the preparation processes are ritually correct. Sheep from Syunik, as well as from other Armenian regions, and Karabakh as well, will be brought to this location.

in this no-peace no-war situation, the Azerbaijani leadership is likely to continue to resort to lower-intensity and lower-risk activities, such as what has become regular sniper fire and less frequent aerial maneuvers and special operations

As for raising sufficient quantities of sheep for Iranian export, several contradictory stories remained unresolved by year’s end. Iranian media had reported that a written agreement reached between Iran’s Azerbaijan region, and the Syunik marz will make it possible for Iran to lease tens of thousands of hectares of Armenian land for sheep grazing.

The document itself, initially kept from the Armenian public, was eventually published in Armenian media. It indicated that the agreement refers to at least 50,000 hectares for a period of 10 years. In October, Armenia’s vice-minister of territorial administration said the issue is closed and no such lease arrangements will be made.

Trade with Iran remains low, despite consistent growth in both exports and imports over the last few years. In 2012, imports amounted to \$219.4 million and exports \$108.5 million. In the first 10 months of 2013, trade decreased by 9.3 percent, to a total of \$246 million. Iranian–Armenian trade constitutes 5.2 percent of Armenia’s total external trade.

ARMENIA – GEORGIA

It is probably Armenia–Georgia relations more than any other that changed overnight and drastically in 2013. For the last decade and a

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half, Armenia and Georgia were headed towards the European Union. Despite all their differences — political, economic, geographic — they shared that European direction. On September 3, that changed. Armenia–Georgia relations are entering a new unknown phase, conditioned by geopolitical shifts in the region.

On September 3, Armenia’s president expressed interest in joining the Russian-led Customs Union (members: Russia, Belarus, Kazakhstan) and in 2015 also join the yet-to-be-created Eurasian Union.

In June, at the G8 Summit in Ireland, the presidents of the three Minsk Group co-Chair countries issued a statement expressing “deep regret that, rather than trying to find a solution based upon mutual interests, the parties have continued to seek one-sided advantage in the negotiation process

Armenia is a member of the Commonwealth of Independent States and the Collective Security Treaty Organization. Georgia, with whom Armenia shares a 200 kilometer long border (125 miles) is not and has expressed its clear desire to join both NATO and the European Union.

Georgia and Armenia have seen serious differences in political direction and priorities, yet both have been particularly careful about not exacerbating them and maintaining normal relations between the two countries in order not to endanger the region’s fragile stability.

Some 70 percent of Armenia’s trade goes through Georgia. Thus, Armenia’s membership in the Customs Union will naturally affect economic cooperation and trade relations adversely, if both countries don’t specifically focus on improving and deepening economic cooperation, especially given cool Russia–Georgia relations.

Improved Georgian–Russian relations is clearly in Armenia’s interest. With movement forward in that direction, then Armenia–Georgia–Russia cooperation would help keep Armenia from total regional isolation, which has become the intended and unintended consequence of the deepening Turkey–Georgia–Azerbaijan axis.

The Kars–Tbilisi–Baku rail line will begin operating in 2014. Building began in earnest when the oil began to flow from Baku to Ceyhan and Azerbaijan was able to offer Georgia low-interest financing to begin the process. It stopped for a short time as a result of the Georgia–Russia war. The new rail connection circumvents the existing line that for nearly a century connected Kars to Baku thru the Armenian city of Gyumri. For that reason, the EU or the US did not offer funding in order not to contribute to the isolation process.

In January, immediately after his visit to Baku, Georgia’s new prime minister visited Yerevan. There, he said Armenia could serve as an example to Georgia in its foreign relations — referring to Armenia’s ability to maintain normal relations with Russia and the West.

This statement, coupled with an earlier one he had made about the questionable cost-effectiveness of the proposed Kars–Tbilisi–Baku railway, raised concerns among the Western-leaning forces in Georgia.

In April, several hundred Armenians from Javakheti demonstrated in front of the Prime Minister’s residence in Tbilisi. This was the first time, since Georgia’s independence, that the Armenians who form a majority in Georgia’s southern Samtskhe–Javakheti region, resorted to such means to call attention to their socio-economic problems. Among other issues, the demonstrators pointed out that all the local governance bodies were still led by those in President Saakashvili’s camp. The government official who met with the demonstrators was the Minister of Re-Integration, the same one whose portfolio includes the Abkhazia and S. Ossetian conflicts.

In January, Vahagn Chakhalyan, accused by the previous administration of being an ideologue for

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Armenian separatism in Javakhk, was released after serving several years in prison on charges which included unlawful possession of firearms. A Georgian Parliament decision to offer amnesty to prisoners also resulted in freeing two other Georgian–Armenians, both Armenian community leaders, charged with spying for Russia. The Armenian Church Diocese of Georgia considered them political prisoners.

A series of high-level visits in 2013 included Georgia's defense and foreign ministers visiting Yerevan in March and April, respectively. The two foreign ministers also met in New York in September and in Tbilisi in November. Armenia's foreign minister was present at the inauguration of newly-elected President Giorgi Margvelashvili.

When Armenia's defense minister visited Tbilisi, he met not only with his counterpart but also with Prime Minister Ivanishvili. The foreign relations committees of both parliaments met near the Armenian–Georgian border, in Armenia's Lori region.

Armenia is among Georgia's top 10 trade partners. But Georgia makes up less than three percent of Armenia's total trade. The total volume — \$123.2 million dollars is still 34.8 percent higher than trade in the same period in 2012. Georgia holds seventh place for Armenian exports — in the first 10 months of 2013, that constituted 5.7 percent. Exports to Georgia fell in 2009 and in 2012; they formed \$71 million, which was still \$11 million less than the 2008 figures.

ARMENIA – RUSSIA

The year marked the lowest point in Russian–Armenian relations since independence. Never before has Russia so blatantly pressured Armenia, the Armenian government so badly mismanaged its most important foreign relationship and the Armenian public been so openly angered by Russia.

In early September, Armenia's president Serzh Sargsyan shocked most Armenians when on a visit to Russia he declared his government's intention to join the Russia-led Customs Union and become

one of the founding members of a new Eurasian Union. The declaration ran contrary to previous rhetoric by Armenian officials who for years discounted – if not dismissed – the possibility of such membership. The immediate cost of the declaration was a halt to plans for an association and trade agreement with the European Union. Incredibly, Armenian officials denied the policy turnaround was a result of pressure.

As part of its effort to minimize international interaction with the Armenian side, Azerbaijan has both expanded and publicized its 'black list' of officials, journalists, artists and others who visit Karabakh

A drumbeat of Russian warnings began months before Sargsyan's September declaration. A number of former Russian officials and other public figures close to Armenia – including a former ambassador – publicly criticized Armenia's intention to sign the Association Agreement with the European Union and reluctance to integrate with Russia. In April, Azerbaijani President Ilham Aliyev revealed that he had secured more than \$4 billion worth of contracts for arms supplies from Russia. Armenia's president appeared to try to postpone taking difficult decisions, skipping two Russia-led summits in May, no doubt further irritating Russia's Vladimir Putin. In June Azerbaijan's military parade displayed new tanks and artillery systems that Russia had delivered just weeks earlier. More talk of arms deals was heard when Putin visited Azerbaijan, ahead of Armenia, in August.

When Putin finally came to Armenia in December (the trip had been postponed since 2012), the cost-benefit calculations involved in Armenia's September decision became even clearer. Putin declared that henceforth and in anticipation of Armenia promptly joining the Customs Union – perhaps as early as February 2014 – Russia would

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drop tariffs on natural gas, hydrocarbons and rough diamonds sold to Armenia. He also hinted that in the absence of that decision, Armenia could be paying as much as Russia's European customers – up to \$400 per thousand cubic meters of natural gas.

Armenia's energy minister also revealed that contrary to past government claims, Russia had effectively raised the price for natural gas to Armenia at the end of 2011 to \$270 for a thousand cubic meters, resulting in a fresh \$300 million debt over two years. As part of the debt repayment, Armenia transferred to Russia its remaining 20 percent share in Armenia's natural gas utility, making it a fully-owned subsidiary of the Russian state-owned Gazprom. Putin's visit also marked the formal launch of the fifth bloc of the Hrazdan thermal power plant after some \$300 million in Gazprom investments. Russia remained Armenia's single largest foreign trade partner, with trade reaching \$1.1 billion in the first eight months of year, with expectations of matching or surpassing the \$1.3 billion in trade turnover reached in 2012.

Armenia intends to maximize its advantageous position in anticipation of international attention

Sargsyan took four trips to Russia, three of them in September. In June, Armenia's media, including the government-connected outlets, had helped fuel public anger over mistreatment of an Armenian citizen charged in a road accident near Moscow that left 18 bus passengers, including children, dead. Just two weeks after the Customs Union declaration, the Armenian president attended the consecration of the huge new Armenian cathedral in Moscow, a ceremony also notable by the absence of any senior Russian officials. Putin's visit to Armenia in turn was marked by the first-ever public protest of a visit by the Russian president.

In contrast to frequent visits by European legislators, just a single Duma member, representing a non-ruling Just Russia party, visited Karabakh during the year.

ARMENIA – EU

In July, the European Union concluded the seventh and final round of trade talks with Armenia and deep and comprehensive free trade area, as part of the association agreement, negotiated for more than three and a half years and expected to be signed in November at the EU Eastern Partnership summit in Vilnius. President Sargsyan's declaration on Armenia's plans to join the Customs Union nixed those plans. Russia's pressure also forced Ukraine to postpone signing its association agreement with the EU, with Moldova and Georgia the only two of the original four candidates going ahead. Armenia's and Ukraine's decisions caught EU officials offguard.

The European Union countries continued to account for the largest share of Armenia's foreign trade turnover, amounting to \$1.1 billion in the first eight months of the year, virtually unchanged from 2012. Raw materials – mostly copper and molybdenum exported to Germany – accounted for 80 percent of Armenia's exports to EU countries. The potential impact of Armenia's membership in the Customs Union on Armenia-EU trade remained unknown.

Throughout the year, talks continued on the potential entry of Carrefour retail chain into Armenia and the public and private resistance of Armenia's own supermarket chain owners, all of them in parliament or government. In November, the French ambassador to Armenia indicated that Armenia was open to Carrefour, but it remained unclear when the first supermarkets might actually open. Meantime, British Orogen Gold (Geoteam) secured mining concessions in Armenia's Vayots Dzor province and the company reported fresh gold discoveries in August.

The year began on a positive note in Armenia-EU relations, as the Armenian government received a generally positive assessment of the conduct of presidential elections in February that saw President Sargsyan re-elected to a second term. Sargsyan's bid was effectively endorsed by the European People's Party (EPP) – the largest right-of-center grouping of political parties in Europe, with which Armenia's ruling Republican Party is affiliated.

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In March, Sargsyan attended an EPP conference in Belgium and another EPP event in Austria in June. Also in June, Sargsyan went to Poland and the following month attended an Eastern Partnership summit in Moldova. The Armenian president also paid a visit to France, including the Council of Europe, in October, and attended the Vilnius summit in November, where instead of the negotiated association agreement, Armenia and EU issued a broad statement on continued cooperation.

A number of senior European officials visited Armenia throughout the year, including a number of parliamentarians from the UK, France, Germany, Denmark, Czech, Greece and the European Parliament. Some also visited Karabakh.

ARMENIA – US

The United States did not send a single senior official to Armenia during 2013. Armenia's foreign and finance ministers paid regular, low-key visits to Washington. Late in the year, President and Parliament Speaker of Nagorno Karabakh were in US to attend the annual fundraising telethon and a congressional briefing, held in Los Angeles and Washington, respectively. A delegation of California state and city officials went to Yerevan and Stepanakert in September.

In November, fresh off a diplomatic breakthrough with Iran, Secretary of State John Kerry appeared to revive US interest in the Karabakh peace process while helping secure the first Armenian-Azerbaijani presidential summit in almost two years. It was unclear if Kerry's involvement would continue.

US-Armenia trade amounted to \$197 million in the first ten months of 2013, a 2.6 percent increase over the same period in 2012.

In April, the 2014 US Budget was released, with a 38% cut in economic aid to Armenia. If the proposal is approved by Congress, aid to Armenia will be reduced to its lowest level since the 1988 earthquake. The Administration proposed \$25 million in Economic Support Funds for Armenia which was dramatically less than last year's actual

economic aid allocation of \$40 million. In the end, for the first time in more than 20 years, there was no specific aid allocation for Armenia, as well as most countries. Aid for Karabakh will probably be kept at the same levels of previous years — about \$2 million — but the allocation for Armenia will probably see a drastic cut in accordance with the budget compromise with the Republicans.

The Armenian government approved in principle plans to privatize the Vorotan hydro-energy cascade. ContourGlobal purchased the cascade for \$180 million, making it the biggest private American investment in Armenia to date.

At the end of the year, after Armenia's gas deal with Russia became public, the Iranian ambassador in Yerevan announced that Iran can provide Armenia with cheaper gas. Armenian officials responded saying it's possible to negotiate such a deal if the Iranian gas price does not exceed \$189

On September 28th, the Government of Armenia and the United States Agency for International Development (USAID) signed an Assistance agreement called "More participatory, accountable and effective government."

OUTLOOK

The reset of US-Russia relations did not produce tangible results, on the contrary, their disagreements and contradictions deepened. The same can be said for Russia-European Union relations, taking into consideration, among other contentions, the events at year-end when Armenia declined to initial and Ukraine to sign the Association Agreement with the European Union. Because of a lack of clear vision and

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foreign policy anchor, Armenia will continue to fall victim to the consequences of those contradictions and will be deprived of potential benefits that positive engagement with both sides would provide.

At the end of 2013, the dividing lines in the Caucasus were further delineated. If European integration had been the only remaining common consideration for Armenia, Georgia and Azerbaijan, that too vanished. Georgia remained faithful to its European orientation, Armenia retreated from it and Azerbaijan maintained neutrality. This will have a negative impact on developments in the region in 2014 and beyond.

Although Turkey will be preoccupied with its domestic troubles and upcoming elections, it will continue to feign readiness for concessions and closer relations with Armenia. On the threshold of the 100th anniversary of the Armenian Genocide, it will be extremely important for Ankara to create the illusion of establishing relations and thereby discouraging the international community from making statements. Armenia, taking into consideration the Diaspora factor and its recent miscalculations on relations with Turkey, will try not to be pulled into Armenian-Turkish processes.

Armenia's parliament remains ready to ratify the protocols if Turkey's parliament ratifies them first, and if clear guarantees for its post-ratification implementation are given.

Opening of the Armenian-Turkish border in 2014 is unlikely because of the improbability of any potential progress on the Nagorno Karabakh issue.

Despite optimistic expectations of the OSCE Minsk Group regarding the process of the Karabakh conflict, any positive development for its settlement is highly unlikely. The two sides have never been farther apart in their positions. In 2014, Azerbaijan will continue efforts to neutralize and retreat from the Madrid document or any other alternative where the clear right of self-determination for Nagorno Karabakh is codified.

In December 2013, Azerbaijan signed an agreement with British Petroleum to build a

pipeline where Azerbaijan will supply Caspian natural gas to Europe through Turkey. In the coming years, it is expected that the European Union will receive two percent of its natural gas demand from that pipeline. In 2014, this project will continue to be a strategic undertaking.

The European Union is unlikely to propose a new format for cooperation with Armenia. The EU will expect that Armenia specify what it is prepared to do. However, any future interaction between Armenia and the EU will be marred by suspicion and distrust.

A thaw in Iran-US and Iran-West relations may occur if Iran's president and the country's spiritual rulers on the one hand and the leaders of the West on the other hand are mindful of the expectations and interests of the other side.

Although Georgia's democratically elected government and president, contrary to the previous administration, have adopted a more realistic and less belligerent policy in relations with Russia, still, conditions are not in place to overcome the Tbilisi-Moscow crisis. Georgia is determined to continue its European integration policy, which Russia views as the European Union's and NATO's expansion into its sphere of influence. Russia will not retreat from its recognition of Abkhazia and South Ossetia, therefore serious progress in Georgian-Abkhaz and Georgian-South Ossetian negotiations will not take place.

POLICY OPTIONS

Armenia must clarify its policy with regard to the European Union and soon. Taking into consideration that membership in the Customs Union will proceed quickly, Armenia, from the outset, must demonstrate initiative and restart negotiations with the European Union and try to restore trust. Additionally, using the reform package within the Association Agreement as a foundation, it must present its own proposals to the European Union.

Conscious of the fact that European integration, the only common platform for Armenia and

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Georgia, no longer exists, in 2014 Armenia must demonstrate greater effort and initiative to clarify its relations with Georgia including programs to realize economic integration.

The recent visit to Armenia of Turkey's foreign minister, the statements and the leaks that followed it, suggest that Turkey has begun to pre-empt and prevent all possible undesirable developments on the threshold of the 100th anniversary of the Armenian Genocide. Armenia must develop clear approaches and steer events, rather than consistently react. In connection with the 100th anniversary, Armenia must define programs and initiatives.

Yerevan must exhibit initiative in order to remedy the crisis in Armenia-Turkey relations and to restore those relations to at least the 2008 football diplomacy level. It will be an unfavorable situation for Armenia if Yerevan continues its position of former years, namely that Yerevan has signed the two protocols, it has done what was expected of it and the ball is now in Turkey's court. The current situation where the protocols have neither been ratified, and Armenia has not retreated from them, exclusively serves the interests of Turkey.

With regard to Nagorno Karabakh, Armenia must prevent Azerbaijani attempts to retreat from the Madrid document and start negotiations anew. Azerbaijan's motivation stems from its desire to remove from the international community's mindset the already entrenched principle of the right to self-determination for the people of Nagorno Karabakh.



ELECTION BUT NO SELECTION

There were four dates which, taken together, represented Armenia's significant political and social developments in 2013: February 19, July 19, September 3, September 4. On the first two of those dates, vocal segments of the Armenian public took to the streets — for different reasons, but with the same message: that their voices be counted. On the two successive days in September, the president adopted one policy and hinted at another, both of which will change the course of Armenia's future.

This was a year for elections. Both the president as well as the mayor of Yerevan were re-elected to their posts in 2013.

February 19, the day after the presidential election, one of the candidates challenging Serzh Sargsyan, Raffi Hovannisian, claimed that he had received not just 35 percent of the vote, as the Central Electoral Commission announced, but a majority, and was indeed the president-elect. From February 19 to mid to late April, more Armenians exhibited more ownership of the electoral system, than at any time in the recent past. Insisting their voices had not been heard or counted, rallies took place throughout Armenia.

The presidential election took place on February 18 and was in many ways, simply the last chapter of the parliamentary elections held the year before. President Serzh Sargsyan who had campaigned alone, as he had when he headed the ticket for the Republican Party during the parliamentary election, was announced the winner within hours of the polls closing.

The day itself was quiet, largely without overt tension or violence. Gone were the days of lights going out, ballot boxes being switched, or proxies being beaten.

Seven candidates were on the ballot: Along with the president, there was former foreign minister Hovannisian of the Heritage Party, former prime minister Hrant Bagratyan, Soviet dissident Paruyr Hairikian, and three public figures — Andreas Ghukasyan, Vardan Sedrakyan and Arman Melikyan. The other three parties in parliament — the Prosperous Armenia Party, the Armenian Revolutionary Federation Dashnaktsutyun, the Armenian National Movement — did not run candidates. Nor did they support the president's candidacy. Thus, Raffi Hovannisian benefited from the protest vote.

The absence of other serious opposition was a manifestation of the message delivered by the Republican Party beginning soon after the parliamentary election, that the game is over, the winner is clearly the incumbent president. The public appeared to agree, believing that would be the outcome, regardless of the actual votes cast. The Republican Party's unilateral hold over the executive, legislative and judicial branches, as well as most regional and local governance bodies gave credence to this assumption. The Republican Party had access to serious administrative resources..

Perhaps this fait-accompli environment was the cause for the refusal of the three parliamentary factions to participate with their own candidates. The Prosperous Armenia Party which had garnered more than 30 percent of the vote during the parliamentary election just eight months earlier, had all along indicated its intention to participate in the presidential poll. At the last

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moment, in early December, they made an announcement to the contrary.

The Armenian National Congress leader, former president Levon Ter Petrossian used his age — 68 years old — to explain the lack of a candidate.

The absence of other serious opposition was a manifestation of the message delivered by the Republican Party beginning soon after the parliamentary election, that the game is over, the winner is clearly the incumbent president.

The ARF Dashnaktsutyun presented a series of unrelated reasons from claims that the outcome is clear, to the inability of the parties to agree on a joint candidate.

President Sargsyan's campaign slogan was "Towards a Secure Armenia." Hovannisian used "It's Possible."

The campaign was marred by a shooting incident which was described as an assassination attempt against one of the candidates. Hairikian was shot at by several men who were later linked to candidate Sedrakyan. All were found guilty and incarcerated. Sargsyan received Hairikian while in hospital, and later, after the election, allocated 20 million AMD for Hairikian to receive treatment abroad.

Meanwhile, Ghukasyan, whose campaign slogan was "An End to Artificial Elections" conducted a hunger strike, on the steps of the National Academy building during the whole of the four-week campaign period. Ghukasyan called on all the candidates to pull out of the race in order not give credence to the "preplanned and preordained campaign" of the ruling powers. This did not happen.

There were no other extraordinary incidents. Nor were there any opportunities to hear the

candidates in a debate setting. The President did not agree to participate in any of the debates proposed by various broadcast and online channels.

Sargsyan's campaign consisted largely a series of prepared remarks, almost exclusively away from Yerevan. The three times during the campaign when he spoke extemporaneously, his remarks, on-camera, were extensively distributed online. From "Next you'll accuse me for making your cucumbers grow crooked," in response to a man complaining that his children must migrate to find work, to "What percentage of votes do you want me to get? What do you want me to hit? 90? 80? 70? Whatever you want, that's what we'll get," to a reporter who asked what the president considers the winning percentage of votes — the answers were the subject of derision.

The voter lists remained a serious concern. The four parties had attempted, in the parliamentary election period, to receive access to the lists of those who actually voted, as a check against possible fraud, but this had not worked. Yet, there were 2,529,000 names on the voter lists for the February 2013 presidential election, 43,000 more than in the unexplainably smaller 2,486,000 that comprised the May 2012 lists. The opposition insisted these 'extra' names are used to falsify votes in favor of the incumbent. On election day, observers noted sets of similar-looking signatures back-to-back.

Other misuses of administrative resources, noted also by the OSCE ODIHR, included the mandatory participation of civil sector workers, including teachers and their students, in weekday campaign events. The observers also noted crude violations of electoral law: various incidents pointing to vote fraud, including ballot marking and submission, disappearing ink intended to prevent repeat-voting, and vote buying — at a rate of 5,000 AMD as cited by the international observers.

Just a few hours after the polls closed, Raffi Hovannisian charged massive voter fraud. Hovannisian had received a surprising 37 percent of the vote, significantly higher than the 22 percent recorded for presidential candidate (and former president) Levon Ter-Petrossian in 2008.

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Unlike Ter-Petrosian, whose speeches consisted of serious charges leveled at the candidate, and at the former administration, Hovannisian's door-to-door, village-to-village countrywide campaign and its warm, inclusive message, was novel for Armenia. His signature handshake and greeting "Barev" gave the campaign the name "The Barev Campaign."

The name changed to "Barevolution" a few days later. Beginning on February 19, Hovannisian and his supporters held mass rallies in Yerevan and other cities. At the Freedom Square rally of February 20, several political figures joined the protestors. On February 21, Hovannisian and thousands of his supporters headed to the President's offices. Hovannisian entered the building, met with the president, and proposed three possible outcomes to the public dissatisfaction: the president's resignation, new presidential elections or new parliamentary elections. President Sargsyan rejected all three possibilities.

The next day there were more than 10,000 protestors at the Square. The ARF Dashnaksutyun announced it was joining the protests. Armen Rustamyan, a member of the ARF's parliamentary faction, and head of the ARF in Armenia, said that on February 18, election day, the Armenian citizen rebelled against "injustice, hopelessness and emigration." The Armenian National Congress went further. Ter-Petrosian openly declared that Hovannisian had won the election. Still, the struggle remained Hovannisian's and Heritage's alone. The backlash to the election was not a united one.

On February 25, the official returns were announced. According to the Central Electoral Commission, there was 60 percent voter participation, with the following vote count:

Serzh Sargsyan (58.64 percent of the vote) — 861,373 votes
 Raffi Hovannisian (36.74 percent) — 539,693
 Hrant Bagratyan (2.15 percent) — 31,643
 Paruyr Hairikyan (1.23 percent) — 18,096
 Andreas Ghukasyan (0.57 percent) — 8,329
 Vardan Sedrakyan (0.42 percent) — 6,210
 Arman Melikyan (0.24 percent) — 3,520

Hovannisian and Ghukasyan appealed to the Constitutional Court, independently. Both asked that the election results be declared null and void. The Court did not satisfy the appeals.

The official vote count showed that Hovannisian won 55 to Sargsyan's 45 in all electoral districts where voter participation did not exceed 60 percent. Where voter participation numbers were higher, Sargsyan won 68 to 32.

There were no other extraordinary incidents. Nor were there any opportunities to hear the candidates in a debate setting. The President did not agree to participate in any of the debates proposed by various broadcast and online channels.

According to Transparency International, excessive voting was not registered in precincts where there was consistent and serious monitoring by observers. Transparency also noted that 64 percent of voters (in 886 out of 1988 precincts) must have voted in less than 60 seconds – something considered highly improbable, but serving as a likely indicator of violations not statistical aberrations.

There was concentrated effort to include domestic observers to the hundreds of international observers invited every year. Over 200 Diasporans, too, were recruited and trained to follow the voting process and vote count.

Other findings also raise questions. In some rural communities, voter turnout was 90 to 95 percent, and Sargsyan received nearly 100 percent of the votes. In a few of these villages, the village population is smaller than the number of votes recorded.

The OSCE ODIHR final report remarked upon these statistical anomalies and noted that they

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raise questions about the fairness of the electoral processes and point to the possibility of serious violations.

Sargsyan won in all regions, except the northern region of Shirak. In Gyumri, the center of Shirak, and Armenia's second city, Sargsyan received only 27 percent of the vote. Perhaps coincidentally, perhaps not, neither Sargsyan nor any other high level government officials have visited the city since, not even on the occasion of the 25th anniversary of the earthquake which shook Gyumri in 1988.

The international community recognized the outcome of the elections. The European Union leadership welcomed the progress made.

The voter lists remained a serious concern. The four parties had attempted, in the parliamentary election period, to receive access to the lists of those who actually voted, as a check against possible fraud

Hovannisian reacted negatively to these statements, as he did to the speedy congratulations offered the president by the Catholicos of All Armenians. Hovannisian blasted the head of the Armenian Church, and in turn was at the receiving end of the patriarch's calls to put a stop to the hunger strike and adopt more constructive methods of protest.

Hovannisian had resorted to a hunger strike after a period of visiting towns and villages throughout Armenia. In places where he had received a majority of the votes, the turnout was warm and welcoming. In other towns, where administrative resources were used, violent provocations were not unusual. When this happened in the town of Sevan, and in the presence of the mayor who threatened his group and suggested they leave and go have it out with Sargsyan, Hovannisian put

an end to the public meetings and the three-week hunger strike began, with the purpose of urging President Sargsyan to step down before the April 9 inauguration date.

Daily forums, public exchanges, lectures, performances, concerts filled up the days at Freedom Square and kept the protestors' hopes alive. Hovannisian and Sargsyan exchanged some letters, but no political change was forthcoming. Hovannisian was proposing new presidential elections, or "sharing the rule with the people." By this, Hovannisian suggested special parliamentary elections by year's end, replacing the governors of half of Armenia's 10 regions with Hovannisian's candidates, and also fill the positions of Prosecutor General, State Revenue Chief, National Security Service to Hovannisian followers. Sargsyan's counter-offer was that Hovannisian head the soon-to-be-created Constitutional Reform Commission. This was turned down. On April 1, Hovannisian resumed what appeared to be a repeat pilgrimage throughout Armenia, calling on the public to join him in Freedom Square on April 9 at his inauguration ceremony.

Thus, on April 9, two inauguration ceremonies took place — one official, highly constructed and scripted, down to pre-filmed shots of the motorcade, and another for the public, unscripted, unpredictable, unclear.

The official inauguration ceremony, which had every election since independence, taken place in the Opera, was moved to the hard-to-access Demirjian Concert Complex near Tsitsernakaberd. None of the representatives of the four parliamentary factions attended. Armenia's second president, Robert Kocharian, was present, as was the president of Karabakh. First president Levon Ter-Petrossian had not received an invitation. Neither had Hovannisian.

Simultaneously, in Freedom Square, Hovannisian took an oath to a "new Armenia." He and his thousands of supporters marched to a nearby square, and placed flowers in memory of the 10 people who were killed during the March 1 events, in the violence that followed the 2008 presidential election. Then they moved towards the presidential offices, only to be met by police barring their way. After a return to Freedom Square, they headed to

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the presidential offices again, and again the police obstructed their path. There were altercations, and among those hurt was a member of the Heritage Party leadership. The evening ended in uncertainty. Hovannisian went to Tsitsernakaberd to pray, in the company of the police chief. The protestors stayed behind, wondering what had happened.

The protests held in the following days saw less and less participation. Hovannisian later admitted that April 9 was not organized well, but he also declared that he was not prepared to issue “100 notes of condolences nor to participate in funerals.”

Weeks later, Sargsyan re-appointed Tigran Sargsyan as prime minister, in effect endorsing the economic and other policies of the government during the previous five years.

Less than a month after the inauguration, Yerevan held elections to select a Municipal Council, which would in turn choose a mayor. While many expected that the May 5 elections might serve as a proxy, or a continuation, or a settling of scores, or even as a compensation for the shortcomings, faults or sins of the previous two elections, it did not happen.

The losing parties, potentially in a position to aim for a majority by benefitting from public frustration, did not do so intensively, seriously or consistently. The winning Republican Party, on the other hand, in a position to try to demonstrate some semblance of power-sharing or inclusion, was unwilling to give more importance to the process itself than a victorious outcome. The result then was an unsatisfactory election, with the Republican Party winning a 56 percent majority, and the incumbent Republican Party member Taron Margaryan, being elected mayor. Nearly 54 percent of eligible voters cast their ballots. Aside from the Republican Party, the Prosperous Armenia Party, too, passed the minimal threshold, as did the Barev Yerevan Alliance (based on Raffi Hovannisian’s presidential campaign) entered the 65-seat Municipal Council.

CORRUPTION

Within days of the parliament confirming the new government, an article appeared in Hetq,

the publication of the Investigative Journalists Association. They had cooperated with the International Consortium of Investigative Journalists in their Offshore Leaks investigation and published a report about offshore accounts in Cyprus, held jointly by Armenia’s Prime Minister, the head of the Armenian Church Yerevan Diocese, and a businessman friend. While the worldwide expose resulted in a 21 percent decline in the incorporation of new offshore companies and many resignations in governments around the world, in Armenian expose had no serious consequences. It remained the subject of sarcasm and satire and social media banter.

According to the report, the three hold shares in a company called Wilspera Holdings Limited, and according to the prime minister, the accounts were created without his knowledge. Nevertheless, large amounts of cash from bank loans were purportedly funneled to a Wilspera Holdings account. While the prime minister and the archbishop denied knowledge of such holdings and transactions, the Attorney General of Cyprus, when in Armenia attending a meeting of chief prosecutors, categorically stated it is not possible to register a company in the name of an individual without that individual’s knowledge.

The official vote count showed that Hovannisian won 55 to Sargsyan’s 45 in all electoral districts where voter participation did not exceed 60 percent

The questions abound largely because of the history of the funds in the account, which arose from the bankruptcy of one company, the loans it had received from an Armenian bank, the Armenian government’s positive assessment of the company and its business plan, and other administrative linkages.

The personal relationship among the three account holders gave credence to the story. In addition, the lifestyle of the archbishop involved, the unwillingness of the three to directly

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respond to questions, all contributed to a public readiness to believe the story.

After all, companies registered offshore play a huge role in Armenia's economy, especially those in the mining, banking and construction sectors. In 2013 alone, investments from Cyprus, recognized as a center of offshore finance, to Armenia grew 11 times. At year's end, the Washington-based Global Financial Integrity issued a report about illicit financial outflows of capital from developing countries from 2002 to 2011. According to the report, \$6.2 billion disappeared from Armenia, \$17 billion from Azerbaijan, and \$4.5 billion from Georgia.

POST ELECTION POLITICAL ENVIRONMENT

The 13-month election season which began in April 2012 and ended in May 2013 left not only the public even more deeply disenchanted, but the political parties and civil society were affected as well.

The OSCE ODIHR final report remarked upon these statistical anomalies and noted that they raise questions about the fairness of the electoral processes and point to the possibility of serious violations

If the "opposition" mantle belonged to Levon Ter-Petrossian's Armenian National Congress from 2008 to 2013, post-2013 it no longer did so. A series of defections from the Armenian National Congress, lack of clarity about the intentions of the Prosperous Armenia Party, frustration with the Heritage Party and Raffi Hovannisian's inability to hold on to the momentum created around him, and the ARF Dashnaktsutyun's mixed messages have resulted in an open field filled largely by a mix of civic activists who congregate

around issues, and would-be politicians who still lack platforms but insist on regime change.

Among those who have appeared as possible new torchbearers are Nikol Pashinyan, previously a Ter-Petrossian ally, who pleases crowds with his sharp attacks on the government. He and a few other names who have become standard oppositionists are heading the only new organization to have been born of the post-election dissatisfactions. Called Civic Contract, it calls regular public meetings, which are a mix of public forum and collegial concerts. This organization has not been able to attract the masses. It is however the only institutional attempt at a collective citizens response.

There have been other, highly personal, responses. Among them was the reappearance, in November, of a Soviet-era dissident, Shant Harutyunyan, who outright challenged the sitting president's legitimacy and said he would use all means to attract attention to what he called an emergency situation. Several thousand joined him in his protests, until he was promptly arrested after wielding items which could cause harm.

CIVILIC ACTIVISM

In 2013, civic activism continued to replace political party participation. The bulk of public participation revolved around issues which galvanized civic activists, who in turn galvanized large numbers of the public. Citizen participation in political processes was channeled through these periodic outbursts which, more and more, are reactions to policy decisions, rather than mere outbursts of anger.

Yerevan's new parking regulations, and the identity of the private entity which will be administering the system and receiving the fines, was the object of some demonstrations. Throughout the year, there were sporadic protests against construction perceived to be illegal. None were sustainable nor did they succeed in impacting or overturning policy.

July 19 then became the day Armenia's public transport system was 'privatized' by groups of self-organized young people who replaced

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the hundreds of mini-buses which connect the city. They took over the system in protest of the mayor's unilateral decision to raise fare hikes. Drivers and activists cooperated to offer rides and boycott the public transport vehicles. Although the protestors focused for a long time on demanding the resignation of those who had made the hike announcement, the actions extended beyond a protest against something, and turned into a movement in favor of something. Beyond issues of cost, public discussion broadened to include drivers' rights, riders' rights, conditions of buses, quality of service, and regulatory processes. They sustained the organized effort and the coalition-building until the decision was rescinded 7 days later, with a promise to re-visit the issue in 2014.

February 19 and July 19 represented the public's frustration at not having a voice in processes that are, by right, the public's.

On September 3 and 4, the president made two announcements which will also impact the public's right to participate in the country's future.

On September 3, Armenia's president unilaterally announced that Armenia would join the Russia-led Customs Union and not initial the European Union Association Agreement as the public had been led to believe for nearly four years, and longer.

On September 4, Armenia's president named a commission charged with proposing changes to Armenia's constitution. The proposals, expected by spring of 2014, may change Armenia's governing structure and will provide indication of what the president expects will be his role in Armenia's government following the end of his term in 2018.

Responses to the second announcement were limited, since the nature of the proposed changes is unclear. The announcement did say the aim of the constitutional reforms would be to enforce the principle of the rule of law, to improve constitutional mechanisms to ensure basic human rights and freedom, and to provide

a full balance of power and increased efficiency of public administration. But all this was not in context, and unexpected. Thus, it was met with skepticism and distrust, with commentators searching for motives and agendas since there had been no public discussions about the need to overhaul specific provisions of the Constitution because of a demonstrated problem.

The official inauguration ceremony, which had every election since independence, taken place in the Opera, was moved to the hard-to-access Demirjian Concert Complex near Tsitsernakaberd

The nature and depth of responses to the first announcement were complex. Some responded to the content of the announcement — closer relations with Russia, Kazakhstan and Belarus, at the expense of closer relations with the EU. Others responded to the manner in which the announcement was made — in Russia, not in Armenia; in stark contrast to comments made in the past by every high office holder; with extreme acquiescence; unilaterally. Most telling was what the process said about balance of powers. Literally within days of dismissing the Customs Union, several high-level officials did a complete about-face and expounded on the decision, with no debate.

As unilateral governance became the norm, public space shrank as well. According to Freedom House, the countries of the former Soviet Union (minus the Baltic States) are the only region in the world where political rights and civil liberties have been in decline since 2001. Armenia is no exception.

The US State Department released its 2012 Human Rights Report stating that Armenia's most significant human rights violations were limitations of the citizens to change the government and fight against corruption, a

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lack of government transparency and limited independence of the judiciary. The report states that authorities used government resources during the parliamentary elections to support the ruling party and reports on credible allegations of vote buying. The report also states that the rule of law was undermined by the allegations of persistent corruption at all levels of government.

While the prime minister and the archbishop denied knowledge of such holdings and transactions, the Attorney General of Cyprus, when in Armenia attending a meeting of chief prosecutors, categorically stated it is not possible to register a company in the name of an individual without that individual's knowledge

In the Transparency International Corruption Perception Index, Armenia ranks better than Azerbaijan, but worse than Georgia. In Armenia, 82 percent of respondents say that corruption is a problem or a serious problem in the public sector, nearly 70 percent believe that the judiciary, public officials and civil servants are corrupt.

In this environment, the Human Rights Defender attempted to make headway in 2013.

Of all the ombudsman's statements of the year, the report which received the most attention was a year-end special report on the judiciary, specifying problems with judicial proceedings, verdicts, double standards and especially a 'bribe pricelist'.

The increase in the amount and intensity of public protests led to an increase in the degree and intensity of police response. The duration of the protests against the bus fare hike offered more opportunity for violent altercations. In late

August, the Human Rights Defender issued several calls following several high-profile beatings of journalists and activists, asking the police to assess the adequacy and legitimacy of police action.

Armenia NGOs acknowledged his public backing of environmentalists' right to protect the rights of certain groups. He also condemned the physical assault of journalists. He had done so earlier in the year, as well. He had also taken on the police during the rate-hike protests, supporting the activists' right to pitch a tent (in the hot August heat). The police ignored both the activists and the ombudsman and disallowed the tent.

POLICE

It was a year of contradictions for Armenia's police force. On the one hand, police response to civic activism included a greater degree of use of force. On the other hand, various aspects of the police system, as institution, were reformed and saw marked improvement.

The difference in use of force was stark. In 2012, there seemed to be a determined effort to respond with restraint. In 2013, there were multiple instances of use of disproportionate force to respond to public events.

The first of those was the response to the alternative inauguration rally held by presidential candidate Raffi Hovannisian, who was protesting and rejecting the official elections results. The rally was followed by a march which was to head toward the presidential building. The police obstructed the march, detained two dozen people. Another two dozen were subjected to police violence, including Hovannisian's Heritage Party member Armen Martirosyan who was occupied with calming the public response to the police.

Just as the police were criticized by the public for these actions, they were also at the receiving end of criticism for their response to protestors at a construction site, arguing about the legality of the construction process. A policeman was accused of sexual assault for kissing a protestor on the neck, while holding her back. Several people were

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detained and later complained about the physical treatment they received in the police vehicles. Those involved in the protests against the transport rate hike also joined those calling attention to police actions. In August, there was a protest rally–march against “Massive Police Repression.” Protestors pointed particularly to the absence of police response to the issues they’ve raised.

But the peak police response came on December 2, as Russian President Vladimir Putin made a one-day visit to Armenia. Protestors had planned a series of events and in response the police, according to civil society representatives, obstructed free movement, freedom of expression and freedom of assembly.

Again, the focus was on the march that was to start in Freedom Square. The police impeded movement, destroyed posters and banners, violently suppressed some protestors and detained others. Over 100 individuals, including journalists, were detained, often for periods longer than allowed by law.

On the positive side, reforms took hold. The police department reacts faster, better, more responsibly to public questions, specific items of criticism, and more frequent reviews in cases of illegitimate activities. There is marked improvement in assessing and collecting punitive fines and in dismissing wrongdoers from the force.

At the beginning of the year, the government adopted the police reform program. The program’s purpose is to make the police department more transparent, more accountable, improve police–public ties and cooperation, adopt the community-minded policing model throughout the country, use more efficient and modern tools to provide for public safety, clarify the transition from a police form to a special civil service division, and to codify special social allowances for those in police service. These and other changes are aimed at assuring accountability. Although many of these steps are being implemented, there is not yet visible improvement in the level of public trust.

Reforming the police education system is also proceeding successfully. More attention is being paid to improve and enlarge skills and knowledge.

The OSCE Yerevan Office supports police reform programs.

Still, the reform program remained incomplete. In part, according to a formal statement where some items were removed entirely, others merely delayed, they cited the need for additional resources, which were not forthcoming either from local or international sources. Among those program items that will not be implemented are the adjustments to social security and pension payments for those in police service.

NGOs

Even as the Freedom of Information Center of Armenia published information about how grants were distributed by the president’s office, 19 new grants were announced. The FOI Center had shown that from 2010 to 2013, from the presidential administrative budget, Armenia provided 500 million AMD (\$1.2 million) to local NGOs for institutional development and other purposes. This would not be a problem except that some of the NGOs were not operational, some names at the managerial levels were repeated for several organizations.

In 2013, civic activism continued to replace political party participation. The bulk of public participation revolved around issues which galvanized civic activists

The October announcement by the Armenian News Foundation, itself an NGO supported by the presidential administration, of new grants applied to 19 organizations. Nearly all coverage included reference to the earlier announcements about questionable distribution of funds.

ARMY

When, in the northeastern Noyemberyan region, a recruit was killed and another received serious bodily harm, the parents of the dead soldier decided to carry the soldier’s body to the Prime

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Minister's offices in Yerevan, as a sign of protest. As hundreds joined the journey, the police stopped the procession near Sevan. The minister of defense and the chief of police personally spoke with the family, asking them not to follow through with such 'extreme' measures. Minister Seyran Ohanian attended the funeral, promised to personally follow the investigation and assured the family that those guilty would be punished. Six military officers, including the commander of the post, were dismissed.

On September 3, Armenia's president unilaterally announced that Armenia would join the Russia-led Customs Union and not initial the European Union Association Agreement as the public had been led to believe for nearly four years, and longer

In another widely-discussed incident, the head of the Vazgen Sargsyan Military Institute resigned when a student was killed, at school.

In an effort to bring closure to a nine-year-old criminal case, in May, the Appeals Court overturned murder convictions on three young men. Still, neither those responsible for the deaths nor those who pursued the convictions of the wrong men, were not identified.

These and other incidents throughout the year led civil society activists and some in the media insisted that these incidents should not be viewed individually, but as a systemic illness and the consequences of unsolved problems. Additionally, investigations are not carried out appropriately, commanders' responsibility is not a factor, and by categorizing these deaths as suicides, the necessary objective and broad investigations are not carried out.

In an effort to deal with these incidents, the Military Prosecutor created a working group to study the effectiveness of investigations conducted in the case of non-combat deaths. Representatives

of five organizations joined the group. However, soon after, two organizations announced it would be impossible to continue to work within such a group given the prosecutor's decision to stop the criminal investigation into the activities of the son of the governor of Syunik Marz. Tigran Khachatryan and his security guard were accused in the death and beating of several xxx. The organizations which left the working group said the one-sided statements of the prosecutor did not instill confidence that the study of the circumstances and causes of the army deaths would in fact not be objective and comprehensive.

When that same military prosecutor was later named Prosecutor General, the public again blamed him for trying to cover up such incidents. The public and the press drew parallels between the release of the governor's son, even as charges were levied against a former military officer who was clearly beaten in that incident, and the death at the hands of security guards of another military man, physician Vahe Avetyan, a year earlier – remarking on the assurance of impunity in both situations.

On the other hand, 2013 saw an increase in the number of corruption cases identified and punished.

Still, the 2013 assessment of Amnesty International was that Armenia's authorities do not tolerate criticism of the situation around the armed forces. The international human rights organizations noted harassment of journalists and advocates who focus on non-combat deaths. Statement cited Police Chief Vladimir Gasparyan who publicly called those who pursue this matter to be unpatriotic and indecent.

In August, conditions in the army was again a public topic, but this time because a soldier wandered into Azerbaijani-controlled territory and was apprehended. Hakob Injighulyan was seen on Azerbaijani television criticizing conditions in the army, talking about corruption, and saying these were the reasons he crossed into Azerbaijan, ostensibly voluntarily.

The Armenian public ascribed his statements to physical and psychological pressure, and the Armenian authorities announced that the soldier would not be subject to criminal charges.

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In 2013, Azerbaijan's use of sniper fire was so great that travel in Armenia was impacted. Both civil and military automobiles received fire. One soldier died, three were wounded. Some roads were closed, others underwent renovation in order to offer alternatives and minimize the danger to civilians.

A series of sit-ins organized by former officers pointed to another of the army's problems – providing sufficient social security, pensions and other staff needs. The protests lasted several months and took place in several cities. A few months into the actions, the leader of the protests was arrested on charges of fraud and embezzlement. His supporters called the charges and the arrest were politically motivated. A number of officers who had been awarded for their conduct during the Karabakh military conflict demonstrably returned their medals, in solidarity with the protesters.

An aspect of the same problems – low salaries, delayed pay raises – was the reason for an increasing number of officers resigning from the armed forces. This may have been the trigger for a six percent budget increase included in the 2014 budget, which is to include a 10 percent salary hike for officers.

The annual draft of 18 years olds took place in the winter this year. It started in December and would end in January. The general assessment seemed to be that the whole process is smoother, and more transparent. Posting sites were picked by lottery, in order to minimize the opportunity for corruption. The monitoring commission followed the process closely.

In other significant reforms, women were admitted for the first time to study at the Sargsyan Military Institute and the Khanperyants military aviation institute. Defense Ministry officials noted this would improve the climate in the army, bring gender equality and that military service would be viewed differently.

Finally, the alternative military service law was also modified. The cases against those who had applied for alternative service was dropped. According to the changes, alternative work

service can be performed by anyone whose religion or convictions completely contradict the essence of military service. Alternative military service will be available to those whose faith prevents use of guns. The length of service was also shortened: Alternative military service period is 36 months the alternative work service period is 30 months.

As unilateral governance became the norm, public space shrank as well. According to Freedom House, the countries of the former Soviet Union (minus the Baltic States) are the only region in the world where political rights and civil liberties have been in decline since 2001. Armenia is no exception

The year saw the beginning of the second strategic defense review. The review will end in 2015, and will articulate long-term assessment of the security environment around Armenia, and assure the necessary corresponding developments for a secure dynamic system by 2020. The purpose is to develop a force that is capable of reacting to military aggression. Thus the review will include identification and assessment of military threats, development of potential scenarios, clarifying the issues facing the armed forces, planning for necessary military capacity, etc.

MEDIA

According to the Freedom House Freedom of the Press index, Armenia's media remain 'not free'. In that the media market is still not self-sustaining, and most media outlets depend on owners with either political or economic agendas, not much has changed. The rest depend on donor support.

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Still, the number of online media outlets grew substantially. Most aggregate the news, increasingly adding lifestyle information from non-Armenian sources as well, and either seeking advertising, or serving as portfolio for their owners or editors.

Of all the ombudsman's statements of the year, the report which received the most attention was a year-end special report on the judiciary, specifying problems with judicial proceedings, verdicts, double standards and especially a 'bribe pricelist'

The existence of online media, especially its capacity to offer live broadcasts, changed the political landscape. The post-election period, Raffi Hovannisian's months-long challenge of the legitimacy of the election, would have gone unnoticed if broadcast media were the only source of information. But online media, specifically CivilNet.TV — and later, one or two others as well — offered continuous live coverage of the protests throughout the country, thus keeping the challenge alive and in people's minds.

Online media proliferated greatly and with the exception of a dozen or so sites which actually produce content, depend almost exclusively on material found elsewhere and repackaged. This became a sufficiently critical challenge for those who do invest resources in production such that about a dozen media organizations and sites together published the beginnings of a code of ethics and protection of copyright. It is too early to say whether publicly proclaiming the intention to defend one's proprietary material will lead to a decline in the copy/paste sites.

Social media — specifically facebook, and twitter to some lesser extent — are nearly the sole source of views for most online media sites. Few outside

the dozen or so larger sites have their own following. Instead, they have views based on the successful promotion of a specific photo or story or headline.

But in 2013, it was not Armenian media's dependent, 'not free' status that stood out in readers' minds. Nor was it the preponderance of new, undefined sites. Rather, Armenian media had found a new way to appear free, become popular and not ruffle political feathers — all at the same time.

Media — especially online media — mastered the art of diversion. Rather than focusing on the story at hand, they managed to divert the public's attention from the issue to the margins. A letter by Serj Tankian, following the presidential election, calling on the newly-elected president for a new, vigorous effort to tackle social ills, was sidelined by artificial questions of authorship. The first visible effort by a name Diasporan to engage in the public life of Armenia was ignored. The questions he raised were sidelined. Instead, the historic moment was diluted to a series of jokes about ghost writing.

An attempt was made to sideline an expose on offshore investments with the Prime Minister's signature. By year's end, when the issue had still not died, some media allowed themselves to be distracted by a prime minister intending to distract.

Media did not pick up on the seriousness of charges resulting from two in-depth articles published by foreign press. The French-based Nouvelles d'Armenie Magazine explored the identity of those who back the European Friends of Armenia organization in Brussels, and demonstrating the organization's mission to serve as a friend of Armenia's leadership, the president especially, rather than a lobbying arm for the country. As a follow-up to that article, the Los Angeles-based LA Weekly published an article on the legal and illegal activities of a US-based and a Moscow-based businessman who have been linked to various activities and expenditures in support of the president. Both articles were met with a resounding silence.

The entrance of Armenia's second president in the discussion of Armenia's economic and political

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direction was dismissed the same way. Instead of questions about the substance of the claims and charges, the discussion devolved to one of timing.

Media manipulation by authorities coupled with diversionary tactics willingly undertaken by media managers has resulted in maintaining the low level of trust regarding media.

Media's willingness to comply with manipulation was also on display when the presidential inauguration ceremonies were broadcast. A rather cloudy April 9 turned up on television as a bright sunny day, with not a cloud in the sky, as footage pre-recorded on the previous Sunday was broadcast, with a LIVE tag, ostensibly following the motorcade entrusted with delivering the bible from the State Manuscripts Library to the inauguration site.

OUTLOOK

2013 came to a close in Armenia on one hand with the parliamentary majority securing the ratification of the controversial, sovereignty-limiting natural gas agreement, and on the other hand, with the unprecedented consolidation of opposition forces. This is a serious watershed which will continue to evolve and deepen during 2014.

The package of constitutional reforms will reveal the government's attempts to perpetuate their grip on power. Expected attempts to prepare for new footholds in power will most certainly lead to further political tension.

If the concessionary tone and approach of the natural gas agreement is any indication, all new legislation pertaining to the Customs Union will follow a similar logic. This will deepen the wedge between the majority and non-coalition parties in parliament and contribute to the further consolidation of alternative forces and efforts.

The weak democratic institutions of the Customs Union and the Eurasian Economic Union will cast a shadow on the prospects of Armenia's democratic development. This must create significant concern for the public, political and civil society forces, and the Diaspora as well.

In 2013 civic and public protests will continue against government abuses, worsening social conditions and the inadequacy of government responses. There will also be resistance against continuing attempts to fill state coffers by further taxing or pressuring the public, and not the oligopoly.

Initial efforts to build bridges and reciprocal support between non-coalition parties and civil society organizations and activists will deepen for greater effectiveness.

A fragmented media will not have sufficient resources to adequately present and explain issues facing the Armenian public, leading to further hopelessness and lack of action.

POLICY OPTIONS

Despite its track record, the government must reconsider and realize the deepening political and social-economic crisis and take steps that will contribute to social unity and political inclusion and participation.

The consolidation of opposition forces, the involvement of wide segments of the public, the media's pockets of impartiality and vigilance together will demand greater transparency and accountability of the government, an acceptance of mistakes and serious efforts to right them.

In the absence of checks and balances in the country's political system, it is imperative that political forces address the country's urgent problems by proposing policies, acting as a counterweight to the authorities' unilateral decisions both inside and outside the parliament on all issues of public interest.

The government must begin to appropriately respond to the critical levels of out-migration (depopulation), before it becomes a threat to national security.

The Diaspora's agenda must expand to include not only the issues of the Genocide and Nagorno Karabakh, but also the two urgent over-arching problems facing the country – halting migration and establishing the rule of law.

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ILLUSIVE GROWTH

“The global economy in 2013 remained suspended between the poles of hope and uncertainty. While recovery gained momentum, particularly in some advanced economies, the world economy is not yet flying on all engines – and is likely to remain underpowered next year as well.” This is IMF Director Christine Lagarde’s assessment the global economy’s performance in 2013, and ours as well.

Indeed, the global economy experienced slow growth in 2013. Despite the hopeful signs recorded in the third quarter, the IMF in October scaled back its annual global growth projections. For 2013, the IMF projected a 2.9 percent growth (lowering its previous projection by 0.3 percentage points) and 3.6 percent growth for 2014.

Three reasons can be identified for the slowdown in the global economy. The first is the possible tapering of the US Federal Reserve’s policy on quantitative easing. The second is the slowdown in China’s economic growth, something which might negatively impact commodity markets. The third is the existing debt problems in the Eurozone, which is slowing growth in Europe.

Although Armenia was affected by global developments, the impact was comparatively

minor, given Armenia’s dependence on remittances from Russia and commodity prices. Copper, molybdenum and other ferrous metals comprise 60 percent of Armenia’s exports and the stable demand in global markets didn’t create any shocks for Armenian mining and metallurgical companies although there was a decline in revenues.

The price of copper in February was at a high \$8,000, decreased to the year’s low of \$6565 in July, and beginning in August, rose again to \$7100. The price of molybdenum hovered around \$20,000 per ton and in December increased to over \$21,000. Copper, molybdenum and other colored metals comprised 60 percent of Armenia’s exports. Sustained demand by international markets resulted in stable sales for mining and metallurgy companies, although total revenues saw a certain decline.

Russia, Armenia’s important trade partner, saw its economic growth decline to 1.5 percent, however that did not impact the level of remittances from Russia to Armenia. Energy prices remained high throughout the year, Russia’s revenues thus remained high and led to high demand in Russia’s economy. This in turn benefitted Armenian exports to Russia. Russia’s healthy economy also fed the demand for migrant laborers, the source of much of the remittances. As a result, in the first 10 months of the year, the total volume of transfers into Armenia (74.4 percent of which is received from Russia) exceeded \$1.8 billion, which is a record compared to previous years.

The drop in global food prices, too, was favorable for Armenia. Armenia, a large importer of food products, is sensitive to price fluctuations for grain, vegetable oil, dairy and sugar. According to the UN Food and Agriculture Organization, the food product price index for November was 4.4 percent lower than the index for the previous year.

Armenia’s economy was not critically affected by international developments. Yet the government attempted to explain away Armenia’s chronic and deepening macroeconomic problems by external factors.

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THE ECONOMIC PICTURE

Just as with its global projections, during the year, the IMF lowered its projections for Armenia as well. As of October, the IMF's annual growth projection for 2013 GDP growth was 4.6 percent, compared to the 5.1 percent at the beginning of the year. For 2014, the IMF is projecting growth at 4.8 percent, compared to the earlier 5.3 percent. According to the IMF, Armenia's growth is expected to decelerate this coming year because of the increase in natural gas and electricity prices, slower growth in the agricultural sector in 2013 after a strong performance in 2012 which was conditioned by favorable weather and periodicity of agricultural crops.

According to World Bank assessments, Armenia's economic growth will hover around 3–4 percent. Armenia's government is also not optimistic. The 2013 state budget was based on an expectation of 6.2 percent economic growth. But the year ended with 4.1 percent growth. Yet at the beginning of the year, the government was so sure of the higher growth rate, that in March, the president stated he expected the government to secure 7 percent economic growth or they would resign. Neither happened.

Although Armenia was affected by global developments, the impact was comparatively minor, given Armenia's dependence on remittances from Russia and commodity prices

Armenia's macroeconomic environment in 2013 remained unstable. The decrease in economic activity was accompanied by high inflation, severe decrease in investments and a cut in real wages. While the first quarter saw 7.5 percent growth, the aggregate for the first three quarters was 2.6 percent. The main driver of economic growth was agriculture. Despite the fact that Armavir saw unprecedented quantities of hail which destroyed most or all of the crops in 41 communities, end-of-year statistics showed 5.9 percent growth

for the agricultural sector. Armavir's farmers blocked roads between their towns and Yerevan, demanding government support. The Prime Minister promised the development of an anti-hail system for Armavir, as well as supported an extension of loan repayments, and the creation of a support fund for farmers.

According to the National Statistical Service, the economic slowdown had begun before the increase in imported natural gas prices; in the second quarter, GDP growth was a scant 0.6 percent. Private investment has decreased steadily for the past five years, which is one of the most important contributors to the slowdown in growth. The ratio of investment to GDP was 40.9 percent in 2008; in 2012 it was 23.8 percent and in 2013 it fell yet again to 22.5 percent. According to the Central Bank, private investment in 2013 will show a decrease of seven percent, instead of the projected increase of one percent.

The decrease in foreign investment is substantial. In the first three quarters of 2013, foreign investment decreased by 31.7 percent, and foreign direct investment by 62.1 percent. Even during the 2009 crisis, foreign investment did not see such a drop. With the exception of the North–South Corridor construction project financed by the Asian Development Bank, not a single major infrastructure program was undertaken in 2013. The groundbreaking for a major joint power plant project (estimated to cost \$350 million) in Meghri, by the Armenian and Iranian governments took place in November, 2012 but construction has not yet begun.

Beginning in June, the inflation rate surpassed the acceptable level (4±1,5 percent) defined by the Central Bank. When the Public Services Regulatory Commission increased the prices for natural gas and electricity on July 7, inflation was already higher than the acceptable rate. By August, the inflation rate was above nine percent, which forced the Central Bank to raise policy rates. The Central Bank estimated that the increase in natural gas and electricity prices directly and indirectly affected inflation by three percent. Price increases for dairy, eggs, potatoes and vegetables also affected the rate of inflation.

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Given the high level of market centralization for food products in Armenia, the significant decline in the international price of grains, oil, and sugar had either no impact, or delayed impact on Armenian prices. The drop in the domestic price of sugar, on the other hand, was twice the decline in world prices.

Poverty remains an acute problem. The rate of inflation in the second quarter continued to steadily surpass the pace of wage hikes, leading to a decline in real wages and a decline in purchasing power. This compounded the country's already deepening socio-economic problems. According to the National Statistical Service, 32.4 percent of the population of Armenia lived in poverty in 2012; 13.5 percent of those are considered very poor and 2.8 percent, extremely poor. Although the 2012 rate is lower than the 35 percent of 2011, compared to 2008 indicators, it is 4.8 percent higher. The extreme poverty rate has increased faster than the general rates of poverty. In 2012, extreme poverty rate was nearly double that of 2008.

Emigration and labor migration continue to remain the main tools of poverty reduction. According to a survey conducted by the National Statistical Service, 29,000 people who left as labor migrants between 2009–2012 did not return to Armenia. This trend persisted in 2013.

Following its appointment in May, the new government adopted a program which placed special emphasis on unemployment through job creation and the development of human capital and institutions. It also focused on increasing salaries and combating migration. The opposition criticized the program as unrealistic and insufficient.

Rumors about the actual price of natural gas imports from Russia continued to remain the focus of political intrigue. Although government officials denied price increases, published reports by Armenia's Customs Agency demonstrated that Armenia in 2011 had imported natural gas from Russia for \$198; in 2012 for \$232 and in the first half of 2013 for \$253 per 1000 cubic meters.

By the end of 2013, it became clear that the public and the legislators were indeed kept in

the dark. The price of gas had been increased immediately prior to Armenia's February 2013 presidential election. For political reasons, the government quietly subsidized the increase to prevent adverse public reaction. It was not until May, ArmRusGazProm, the Armenian–Russian gas consortium, announced that the Russian GazProm would supply Armenia with natural gas at \$270 per 1000 cubic meters, in place of the officially announced \$180. After September 3, when Armenia expressed its wish to join the Customs Union, hopes rose regarding an agreement surrounding the price of gas. A final agreement was signed when Russian President Vladimir Putin came to Armenia on December 2. However, it became painfully clear that Armenia had already accrued a \$300 million debt to the Russians. The Minister of Energy and Natural Resources announced that the price of imported natural gas had in fact increased from \$180 from 2011, and the debt had accumulated over the past three years. That public debt was paid off in the December 2 agreement, with Armenia selling its 20 percent remaining share in ArmRusGasProm.

Armenia's economy was not critically affected by international developments. Yet the government attempted to explain away Armenia's chronic and deepening macroeconomic problems by external factors

Soon after, the ambassador of Iran, Armenia's other gas supplier, announced that, although the Armenian government had not asked, his country is ready to supply Armenia with gas at a lower price. However, he indicated that Iran may no longer be willing to provide gas in exchange for electricity. This, despite a current arrangement by which Iranian imported natural gas costs \$181, and Armenia pays by exporting 3 kilowatt/hours of electricity against 1 cubic meter of natural gas.

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INSTITUTIONAL CHANGES

According to the Doing Business 2014 report published by the World Bank and the International Finance Corporation, Armenia ranked 37th among 189 countries, compared with 40th the previous year. Armenia registered progress in tax collection, company registrations, and contract enforcement indices. It registered a relapse in six indicators, including construction permits, electricity access, loan eligibility, property registration, investor protection and international trade. Its position for bankruptcy regulation remained the same.

Armenia's macroeconomic environment in 2013 remained unstable. The decrease in economic activity was accompanied by high inflation, severe decrease in investments and a cut in real wages

The reduction in the number of mandatory tax reports was a positive development in 2013. Nevertheless the country's ranking of 103 still reflects unnecessarily complex tax administration.

2013 brought to the fore the not-so-secret phenomena impeding business development. The entry into the Armenian market of the French supermarket chain Carrefour was continually delayed due to obstruction by those who currently hold a dominant position in the market. In a World Bank report, monopolization in Armenia is the highest in the CIS and Eastern Europe. According to the report, monopolies, oligopolies and other dominant players constitute 60 percent of Armenia's markets. The World Bank considers such a high degree of concentration as an obstacle to economic growth.

Perhaps in response, the Anti-Trust Commission was granted additional powers and enlarged the scope of fines and procedures within its scope. However, its efforts to prevent and

oversee absorption and market exclusion are insufficient. State procurement auditing processes are fragmentary, although these are among the fundamental means of restricting competition. Overall, restricting competition in Armenia remains a systemic risk.

Armenia fell four places, to 79 out of 148 countries, with a score of 4.1 (where 7 is highly competitive) in the Global Competitiveness Index which measures the institutions, policies, and factors that determine the level of productivity of a country. Specifically on labor market efficiency, as an aspect of competitiveness, Armenia ranks 50, behind Georgia, ahead of Russia. In quality of higher education and training, Armenia ranks 77, behind Russia and ahead of Georgia.

In May, the IMF, too, invited attention to the lack of competition. In a published review of Armenia's economy, Armenia's country director and the head of the IMF Armenia Mission urged the state "to do more to collect taxes; to do more to ensure that its spending is efficient, transparent, and gets to the right places; to ensure that public resources are not used to rescue private firms that have been poorly managed." They advise that the government shift from words to action and open the market for competition.

NEW PENSION POLICY

In 2014, Armenia will implement a new, multilevel pension system. Those born after January 1, 1974, must participate in a mandatory pension system. For those born earlier, participation is optional.

Thus, Armenia's pension system is four-tiered. The first tier is the social pension which will be provided to those with up-to-five years of employment history. The second tier covers those who have worked for more than five years and who have contributed to the social pension fund. The third tier is the mandatory system and the fourth is the voluntary fund.

The voluntary system has been in place since 2011; however, neither individuals nor financial institutions have demonstrated serious interest. As of October 2013, only a few dozen voluntary

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pension accounts have been opened. The mandatory system applies to employees (excluding those in active military service), individual entrepreneurs and notary publics. Five percent of gross income will be transferred by the employer to the employee's compulsory account; the state will contribute an additional five percent but not more than 25,000 AMD. If the citizen's income exceeds 500,000 AMD/month, s/he must, by law, pay the difference up to a total of 10 percent of gross income.

Although the law on pension funds was ratified in 2010, protests against the new system began only this year, as the mandatory provision was about to enter into force. In October, those working in the IT sector — among the highest paid professionals — began mobilizing, demanding changes in the legislation and a postponement of the introduction of the new system. Employees from other sectors also joined in.

The main grievances come from those whose employment and salaries are fully legally registered. In 2013, the unified payroll tax was around 25 percent on average. Thus, with the pension payment, total withholdings will reach 31 percent. For those with a monthly salary exceeding 500,000 AMD, that amount will be even higher. For those who earn one million AMD, withholdings will exceed 33 percent, 7.5 percent of which is the mandatory pension payment. Even for those who are paid well, this new system will impact real wages.

At the crux of these grievances, is a fundamental lack of trust. For the new system to be viable, long-term financial and political stability is necessary, and under the present climate, this cannot be taken for granted. The legislation foresees that 60 percent of funds must be invested in Armenia, either with companies listed on the Armenian stock exchange, Nasdaq OMX Armenia, or in Armenian government bonds. Since the number of companies that qualify are very limited, the bulk of the funds will be invested in government bonds. Any serious shock or upheaval will necessarily impact the value of these bonds.

The high yield of government bonds remains an obstacle to the development of capital markets. Nasdaq OMX Armenia capitalization amounted to about 63 billion AMD as of October 2013, and

the volume of share transactions in the first 10 months amounted to 1.5 billion AMD; two to three transactions are conducted monthly. Bond turnover is ten times less than share turnover. It is in this climate that pension funds will cumulate about 50 billion AMD annually.

If this climate results in the Central Bank's allowing a higher percentage of pension funds to be invested outside of the country, then pension fund reforms will have a minimal impact on economic growth. Two companies have been chosen as pension fund managers: Amundi-ACBA Asset Management, a joint venture of the French Amundi Asset Management, and the Armenia-based ACBA Credit Agricole Bank and the C-QUADRAT Ampega Asset Management Armenia, a joint venture of the German Talanx Asset Management and the Austrian C-QUADRAT.

The decrease in foreign investment is substantial. In the first three quarters of 2013, foreign investment decreased by 31.7 percent, and foreign direct investment by 62.1 percent. Even during the 2009 crisis, foreign investment did not see such a drop

The pension law, which passed prior to Armenia's indication that it would join the Russian-led Customs Union, stipulates that pension funds can only be used to purchase securities issued by member states of the European Union and the Organization for Economic Cooperation and Development (OECD). None of the members of the Customs Union are members of the OECD, although Russia and Kazakhstan are taking active steps to develop their capital markets. It is expected that Armenia will be subjected to pressures to allow securities issued by countries of the Customs Union.

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In November, opposition factions in the National Assembly — the Prosperous Armenia Party, the Armenian Revolutionary Federation – Dashnaktsutyun, the Armenian National Congress and the Heritage Party — joined in an appeal to convene a special session on the possibility of postponing implementation of the mandatory pension component by one year. The Republican Party and its coalition partner, the Rule of Law Party, boycotted the special session. However due to continuing public pressure, the issue was placed on the agenda at a regular session. It did not pass. The opposition parties have appealed to the Constitutional Court.

CIVIL AVIATION

On April 1, Armavia, the sole Armenian carrier, suspended all flights and declared bankruptcy, thus ending its 12-year monopoly. Bad management and the activation of alternate flights by Russian and European carriers were cited as the main reasons for its demise. While enjoying exclusivity for many years, Armavia was not able to compete. According to public documents, in 2010–2012, Armavia owed 21.5 billion AMD in state air taxes. Of that amount, 5.5 billion in taxes and 16 billion in penalties.

Poverty remains an acute problem. The rate of inflation in the second quarter continued to steadily surpass the pace of wage hikes, leading to a decline in real wages and a decline in purchasing power

At the request of Armenia's National Competitiveness Foundation, McKinsey & Company developed policy recommendations to enhance the competitiveness in the air transport sector. They proposed that Armenia completely liberalize the air transport sphere and move toward an Open Skies policy. According to estimates by McKinsey, that policy would, over three to four years, secure GDP growth of \$300 to \$400 million, contribute

to the creation of 18,000 to 23,000 new jobs in the tourism and aviation sectors, increase passenger travel by 20 to 25 percent and lead to a 10 percent reduction in ticket prices.

In October, the government issued a strategy paper adopting a competitive and consistent air transport services policy, appearing to be heading towards Open Skies. It specified that any airline that could secure minimum technical standards, could begin flights to and from Armenia. One new carrier, Air Armenia, immediately began limited but regular service.

EUROBONDS

In September, Armenia issued its first-ever Eurobonds valued at \$700 million, with a 7-year maturity and 6.25 percent yield. From that sale, \$450 million was used to repay the \$500 million loan from Russia (outstanding from 2009) prior to its maturity.

Using proceeds from the sale of the Eurobonds to repay the Russian loan earlier than scheduled was not uniformly welcomed by professionals. The Russian loan had a maturity of 15 years, with a Libor+3 interest rate. In September 2013, a six-month Libor was 0.73 percent. However, the Russian loan assumed repayments of about \$60 million annually, something which had troubled the government. The government must now pay \$42 million annually in interest payments to service the Eurobonds.

In November 2013, Armenia's foreign debt exceeded \$3.7 billion, 18.5 percent of which for the Eurobonds. In 2013, Armenia hit the peak in the external debt repayment schedule, which are estimated to be about \$220 million. It is anticipated that foreign debt in 2013 will be 39.5 percent of GDP. In 2008, state foreign debt was 13.5 percent of GDP, in 2009 it was 34.3 percent and in 2012, it was 35.2 percent.

BUDGET

The 2013 state budget was formed based on the following macroeconomic projections: 6.2 percent

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economic growth, four percent inflation, 3.2 percent deflator. The ratio of the budget deficit to GDP was forecast to be about 2.6 percent. This meant that compared to previous years, a more contractionary policy would be implemented. It was assumed that the economy had overcome the crisis and had entered a period of sustainable growth, therefore it would be possible to strike a delicate balance between economic growth and financial stability.

Based on this macroeconomic forecast, budget revenues were expected to reach 1.033 trillion AMD (\$2.55 billion or 22.76 percent of GDP), expenditures to reach 1.153 trillion AMD (\$2.84 billion or 25.4 percent of GDP), and the deficit would hit 120 billion AMD (2.64 percent of GDP). Tax collectors would be obliged to collect an additional (in addition to what?) 115 billion AMD in taxes.

However, during the course of the year, signs of macroeconomic instability emerged, which impacted budget implementation. Economic activity indices continually decreased over the course of the year. By October, growth registered at 3.4 percent. According to the National Statistical Service, by the third quarter of 2013, compared to the same time period of the previous year, GDP had increased by only 1.4 percent with agriculture playing the biggest role, contributing to growth by 1.1 percentage points. The government's year-end forecasts place GDP growth for 2013 at about 4.1 percent.

With a decrease in economic activity, ensuring revenue for the state budget becomes a complex problem, even if administrative capabilities are strengthened. However, throughout the year, the Finance Ministry continually announced that they had been able to secure almost 100 percent tax collection. In reality, this was due exclusively to higher inflation. Thus, the deflator was higher than predicted. The increase in cost of manufactured products between January and October, compared to the same period in 2012, was 4.8 percent, and freight rates grew by seven percent.

During the year, the rise in prices of consumer goods exceeded nine percent and as of November was 6.6 percent. In this unprecedented

atmosphere of inflation, it was expected that budget revenue, in absolute numbers, would exceed projections. Because this did not happen, the share of budget revenues as portion of GDP decreased.

According to data for the first nine months, budget revenue was 786 billion AMD, 94.4 percent of which came from taxes and fees.

By the end of 2013, it became clear that the public and the legislators were indeed kept in the dark. The price of gas had been increased immediately prior to Armenia's February 2013 presidential election. For political reasons, the government quietly subsidized the increase to prevent adverse public reaction

On the revenue side of the 2013 budget, two new types of taxes were introduced – a unified income tax and a turnover tax. The unified income tax replaced payments for income tax and mandatory social insurance. For the first nine months, income was 177.5 billion AMD (about 24 percents of all tax revenue), of which 24.4 percent exceeded the previous year's income tax and social insurance payments taken together.

Taxes on total turnover comprised 1.2 percent of all revenue, or about 9.1 billion AMD. This tax was applied to those small and medium sized businesses whose total turnover during the course of one year does not exceed 58.35 million AMD.

As with previous years, the main bulk of tax revenues came from the Value Added Tax — 40.4 percent. Moreover, the role of this tax is increasing with each passing year. Some 64

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percent of Value Added Tax is obtained from border taxation and in this regard, this increase continues to exceed revenues from domestic turnover.

The other important source of revenue for the state budget is profit tax, which comprises 13 percent of tax revenue. However, growth of profit tax remittances is less than the growth of VAT remittances. Surprisingly, the volume of profit tax is also less than the volume of income tax remittances. This is fundamentally conditioned by large companies concealing their profit.

2013 brought to the fore the not-so-secret phenomena impeding business development. The entry into the Armenian market of the French supermarket chain Carrefour was continually delayed due to obstruction by those who currently hold a dominant position in the market

State budget expenditures during the course of the year have been marked by shortfalls of about 15 percent. Instead of the forecast 870 billion AMD expenditures, in the first nine months, 740 billion AMD was actually spent. This shortfall affected primarily capital expenditures, which fell to 50 percent. For example, only half the financing for apartment building construction and utilities was utilized because foreign financing for improvements in the water supply system for Shirak, Lori and Yerevan was either not used or was only partially used. About \$25 million was not spent, but with no explanation as to why these funds were frozen.

With capital expenditures postponed, the budget registered a marked surplus. In the first nine months, the budget had a surplus of 75.8 billion AMD, compared to the anticipated 9.5 billion. The unspent balance of the budget did not go below

110 billion AMD, rising to 130 billion in September. The shortfall in capital expenditures had a negative affect on the rate of economic growth because of its contractional nature. According to preliminary assessments, in the first nine months of the year, the amount not spent from the state budget equalled almost four percent of GDP.

OUTLOOK

Despite the International Monetary Fund's optimistic projections for economic growth in the United States, the European Union and other developed countries, growth projections are less optimistic for Russia's economy, which is of huge significance for Armenia. In 2014, growth in Russia will depend on the price of oil. Global economic growth should spur higher oil prices. However, growing energy sufficiency in the US and the possible easing of sanctions on Iranian oil exports may override the growth factor pushing prices downward. If the price of oil were to drop below \$85 per barrel, Russia's economy would face serious challenges, which in turn will have negative repercussions for Armenia.

Armenia's growth outlook is uncertain. President Sargsyan's seven percent growth expectation did not materialize. The economy grew by about 4 percent. Chances of meeting the projected five percent growth in the 2014 budget is low. The increase in budgetary expenses will result in an increase in the tax burden that will inhibit investments and demand, impeding economic growth.

The implementation of the new mandatory cumulative pension system will negatively impact consumer demand and other administrative payments that will begin in 2014.

The 2014 budget is contractionary. There are no state investments, the tax burden is excessive and the supply of AMD in circulation is limited. Year-end attempts to depreciate AMD will not stimulate investments or economic growth because there are no mechanisms for the depreciation would impact commercial interest rates. The business sector has negative expectations. Taking into consideration the high risk in the economy, bank loan terms continue to remain, high, stringent and limited.

Armenia's economy will experience adverse effects from the moment of its membership in the Customs Union. The Customs Union is by definition a free trade zone with common customs regulation. Armenia has always had free trade with Russia, Belarus and Kazakhstan within the framework of the CIS. When common customs regulations kick in, taking into consideration that the customs needs and interests of Russia and Armenia could not be more divergent, its impact on Armenia's economy will not be good. It is also possible that in 2014, certain members of the World Trade Organization may challenge Armenia's moves within the Customs Union, seriously impeding Armenia's trade relations with its partners.

By refusing to initial the European Union's Association Agreement and the Deep and Comprehensive Free Trade Agreement, Armenia lost an opportunity to benefit from a 500 million strong market with enormous purchasing capacity. Armenia will most probably be deprived from the donors conference previously envisaged to provide budget support to Armenia.

POLICY OPTIONS

To secure economic growth, the government must utilize domestic resources. If the government does not retreat from the mandatory cumulative pension system, then at the very least, the revenue collected and invested in government bonds should be directed not at financing current expenses, but toward long-term programs, which will secure economic growth and create new jobs.

To spur economic growth, the government must speed up the construction of the North-South Corridor being funded through loans by the Asian Development Bank.

With the objective of elevating consumer and investor trust, the government must realize systemic reforms, which also include the separation of business and politics.

The government must not only declare but practice expansionary fiscal and monetary policies. Under conditions of the mandatory cumulative pension system, controlling inflation

in the mid-term and long-term is extremely important, however in the short term, preference must be given to the more critical needs of the country, namely economic growth, job creation and poverty reduction.

Taking into consideration the failure to initial the European Union's Association Agreement and the Deep and Comprehensive Free Trade Agreement and the loss of trust toward Armenia by European investors, the government must dramatically improve the business environment and not only by advancing in international rankings, but actually by attracting new investors and stopping the outflow of capital.

THE REGION IN FIGURES

ARMENIA

GDP Growth: 4.6 percent After elections, President Sargsyan’s first foreign trip was to Moscow.

Inflation (annual average): 7 percent Armenia, having negotiated with the European Union for two and a half years, expressed its intention to join the Customs Union. Because of Armenia’s lack of clear vision and foreign policy anchor, it will continue to fall victim to the implications of those contradictions.

GDP: \$10.4 bn

GDP per capita: \$3176

Population: 3.0 m*

Taking into consideration the failure to initial the European Union’s Association Agreement and the Deep and Comprehensive Free Trade Agreement and the loss of trust toward Armenia by European investors, the government must dramatically improve the business environment and not only by advancing in international rankings, but actually by attracting new investors and stopping the outflow of capital.

Government must take steps to reduce out-migration (depopulation), before it becomes a national security threat.

AZERBAIJAN

GDP Growth: 3.5 percent After his re-election, President Aliyev’s first foreign trip was to Ankara.

Inflation (annual average): 3.7 percent During President Putin’s visit to Baku, Rosneft and Socar signed two important agreements. Azerbaijan bought from Russia \$1 billion in armaments.

GDP: \$76.0 bn

GDP per capita: \$8165

Population: 9.3 m

Azerbaijan agreed to export Shah Deniz 2 gas thru two pipelines to Europe, through Turkey.

In 2014, Azerbaijan will continue to water down and pull back from Madrid principles, where the right of the people of Nagorno Karabagh is explicitly codified.

GEORGIA

GDP Growth: 2.5 percent Afer elections President Margvelashvili’s first foreign trip was to Vilnius.

Inflation (annual average): 0.3 percent Georgia became the only country in the South Caucasus that took the next step towards European integration.

GDP: \$16.0 bn

GDP per capita: \$3558

Population: 4.5 m

Despite a less aggressive Russia policy, conditions to overcome the Tbilisi-Moscow crisis are not present. Georgia is determined to continue its European integration policy, which Russia views as expansion by the EU and NATO into its sphere of influence.

Russia will not retreat from its recognition of Abkhazia and South Ossetia, therefore serious progress in Georgian-Abkhaz and Georgian-South Ossetian negotiations will not take place.

* Armenia’s population figure is based on the 2011 census conducted by the National Statistical Service of Armenia.

THE REGION IN FIGURES

RUSSIA

GDP Growth: 1.5 percent Russia registered serious foreign policy successes. Ukraine did not sign the Association Agreement; relations with Georgia saw a thaw; relations with Azerbaijan deepened.

Inflation (annual average): 6.7 percent Russia's engagement in Iran's and Syria's affairs were deemed constructive, even from a Western perspective.

GDP: \$2.117 bn

GDP per capita: \$14973

Population: 141,4 m

Russia-Turkey relations has reached a level of strategic cooperation. Thus, Armenia's strategic partner Russia, has elevated its relationship with Azerbaijan and Turkey to unprecedented levels.

TURKEY

GDP Growth: 3.8 percent Turkey ended the year with serious internal upheaval. The government's response to mid-year protests introduced new tension in Turkish-EU relations.

Inflation (annual average): 7.7 percent

GDP: \$821.8 bn

GDP per capita: \$10745

Population: 76.5 m

With no serious progress in relations with neighbors, Ankara initiated a reconciliation process with its Kurdish population and with PKK.

Although Turkey will be preoccupied with its domestic troubles and upcoming elections, it will continue to feign readiness for concessions and closer relations with Armenia. On the threshold of the 100th anniversary of the Armenian Genocide, it will be extremely important for Ankara to create the illusion of establishing relations and thereby discouraging the international community from making statements. Armenia, taking into consideration the Diaspora factor and its recent miscalculations on relations with Turkey, will try not to be pulled into Armenian-Turkish processes.

IRAN

GDP Growth: 1.5 percent A thaw in Iran-US and Iran-West relations may occur if Iran's civil and spiritual rulers and the West are mindful of the expectations and interests of the other side.

Inflation (annual average): 42.3 percent

GDP: \$388.5 bn

GDP per capita: \$5039

Population: 77.1 m

Iran has made concessions in its nuclear program, has adopted more flexible posture on the Syrian conflict and has put its relations with Turkey at a new level.

Armenian-Iranian relations continue to remain at a high level, despite joint economic projects progressing at snail's pace.

